TAX RULES GOVERNING PRIVATE FOUNDATIONS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

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HOUSE OF REPRESENTATIVES

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TAX RULES GOVERNING PRIVATE FOUNDATIONS

MONDAY, JUNE 27, 1983

House of Representatives,
Committee on Ways and Means,
Subcommittee on Oversight,
Washington, D.C.

The subcommittee met at 10:09 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Charles B. Rangel (chairman of the subcommittee) presiding.

[The press releases announcing the hearings follow:]

[For Immediate Release, Press Release No. 25, Dec. 20, 1982]

Hon. Charles B. Rangel (Democrat of New York), Chairman, Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, Announces Hearings on Private Foundations

The Honorable Charles B. Rangel (D., N.Y.), Chairman of the Subcommittee on Oversight of the Committee on Ways and Means, announced today that hearings to examine the rules governing private foundations will be held early in the 98th Congress. Further details and specific dates for the hearings will be announced later.

These hearings are being scheduled at the request of the Honorable Dan Rostenkowski (D., Ill.), Chairman of the Committee on Ways and Means. In 1969, Congress enacted a comprehensive set of rules regulating private foundations. With limited exceptions, there has been no comprehensive review of these rules since the enactment of the Tax Reform Act of 1969 (Public Law 91-172). In addition, issues relating to the operation of these foundation rules have been raised, most recently during the conference on the Tax Equity and Fiscal Responsibility Act of 1982 (Public Law 97-248).

The Subcommittee will examine the impact of the 1969 Act on the vitality of private foundations. The hearings will address present rules and regulations which may promote or impede the operation of private foundations. The Subcommittee will seek testimony from the Department of the Treasury on its experience with administering the statute, including identification of any specific problem areas. Private tax practitioners, legal scholars, private foundation managers and recipients of private foundation grants will also be invited to testify. Detailed information to develop a profile of the characteristics of private foundations and a survey of their experiences with the 1969 Act will be requested. This information will assist the Subcommittee in determining whether the current rules, without imposing unnecessary or unduly burdensome restrictions, ensure only those private foundations operating for the public benefit enjoy favorable tax treatment.

[For Immediate Release, Press Release No. 5, Tuesday, May 3, 1983]

Hon. Charles B. Rangel (Democrat of New York), Chairman, Subcommittee on Oversight, Committee on Ways and Means, Announces Further Details on Hearings on Private Foundations

The Honorable Charles B. Rangel (D., N.Y.), Chairman of the Subcommittee on Oversight of the Committee on Ways and Means, announced today that the Subcommittee will conduct hearings to examine the rules governing private foundations on

Monday, June 27, and Tuesday, June 28, 1983.[1] The hearings will be held in Room 1100 Longworth House Office Building and will begin at 10:00 a.m. each day. These hearings were previously announced on December 20, 1982 (Press Release No. 25), and are being held at the request of the Honorable Don Rostenkowski, Chairman of the Committee on Ways and Means. Information will be sought to assist the Subcommittee in determining whether the current rules first enacted in the Tax Reform Act of 1969 (P.L. 91-172), without imposing unneceessary or unduly burdensome restrictions, ensure that only those private foundations operating for the public benefit enjoy favorable tax treatment.

Framework for discussion

I. Foundation profile questions

The Subcommittee seeks information on the following general questions:

(A) What role do private foundations play in private philanthropy?

(B) How are private foundations responding to the President's call for increased voluntarism and private sector initiative in light of reduced Federal spending?

(C) What are the sources of funding for private foundations?

(D) What pailanthropic activities are private foundations undertaking?

(E) Who are recipients of the charitable distributions of private foundations?

(F) What are private foundations' payout rates for qualifying charitable distributions?

(G) What types of assets do private foundations have, and what is the rate of return on each type of asset?

(H) What types of investments do private foundations engage in, and what investment policies guide their decision-making regarding investment selections?

(I) What portion of the qualifying distributions of private foundations represent administrative expenses, particularly trustee compensation?

(J) What has been the effect of the Tax Reform Act of 1969 on the operations, vitality and growth of private foundations?

(K) Is avoidance of private foundation status a factor that is considered in deciding upon the format for philanthropic activities? If so, why?

(L) What type of public disclosure and accountability are afforded by private foundations, and how helpful is it to potential grantees and to the public in general?

II. Issues relating to present statutory structure

In addition, the Subcommittee requests comments on the issues surrounding the rules and regulations governing private foundations including, but not limited, to the following:

A. Divestitute requirement for business holdings acquired by gift or bequest

1. What foundations have divestiture problems with regard to excess business holdings, and why?

2. Are there any circumstances under which relief from the divestiture rules would be appropriate?

3. If such circumstances do exist, what form of relief is warranted?

B. Definitions of disqualified persons

1. Are any statutory definitions of disqualified persons unnecessarily stringent or overbroad?

2. If so, what definitions are they and how should they be limited?

C. Expenditure responsibility

1. To what degree are private foundations administratively burdened in exercising expenditure responsibility?

2. To what degree do the expenditure responsibility requirements influence foundations' grant-making decisions?

3. Should the expenditure responsibility requirements be eased, and if so, in what manner?

D. Penalty taxes

1. Are there circumstances in which the automatic imposition of the first-level penalty taxes is unwarranted?

2. Should the Secretary of the Treasury be authorized to abate the first-level penalties?

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[1] Press release No. 6, not printed here, added Thursday, June 30, 1983, as an additional day of hearings.

3. What type of abatement mechanism could be authorized which would in no way lessen compliance with the rules?

E. Two-percent excise tax

1. Is the collection of the 2 percent tax still in keeping with the purpose for which it was originally intended?

2. How are the revenues raised by this tax being used?

3. To what degree does the 2 percent tax erode the resources that are available for charitable purposes?

F. Declaratory judgment procedure

Is the availability of the declaratory judgment procedure too restrictive?

G. Administration of the statutory rules by the Internal Revenue Service

1. Is the "10-percent public support" test set forth in the regulations relating to the definition of private foundation too restrictive?

(a) Should certain organizations which fail to meet the "10-percent" test nevertheless be excluded from private foundation status?

(b) In what ways should the Form 990-PF, Return of Private Foundations, be improved?

(c) Should the regulatory restrictions on reliance by a private foundation on an IRS ruling as to the public status of a potential grantee be modified? If so, how?

H. Compliance

1. To what extent are private foundations complying with the rules set forth in 1969?

2. Have the 1969 rules succeeded in eliminating the abuses the rules were intended to address?

3. Are there any ways in which the current rules can be so manipulated that an organization may avoid private foundation status and the restrictions that follow such status?

I. Simplification

How can existing law be simplified?

Details for submissions of requests to be heard

In addition to testimony received from invited witnesses, individuals and organizations interested in presenting oral testimony at the hearing should submit their requests to be heard by telephone to Harriett Lawler ((202) 225-3627) no later than the close of business, Friday, June 10, 1983, to be followed by a formal written request to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. Notification to those scheduled to appear will be made by telephone as soon as possible after the filing deadline.

It is urged that persons and organizations having a common position make every effort to designate one spokesperson to represent them in order for the Subcommittee to hear as many points of view as possible. Time for oral presentations will be limited with the understanding that a more detailed statement may be included in the printed record of the hearing. This procedure will afford more time for Members to question witnesses. In order to expedite the hearing, witnesses may be grouped in panels with time limitations for each panelist.

Requests to be heard must contain the following information:

(1) The name, address, title, firm affiliation and/or organization the witness will represent (as well as a telephone number where he or his designated representative may be reached);

(2) If appearing in an individual capacity, a list of any clients at whose request or in whose employ the witness appears; and

(3) A topical outline or summary of comments and recommendations.

The above information should also be incorporated in the prepared statements to be presented in person as well as those filed for the written record of the hearing.

In order to assure the most productive use of the limited amount of time available to question hearing witnesses, witnesses scheduled to appear before the Subcommittee are required to submit 50 copies of their prepared statement to the full Committee office, Room 1102 Longworth House Office Building, by close of business, Friday, June 17, 1983. Failure to comply with this requirement may result in the witness being denied the opportunity to testify in person.

Written statements in lieu of personal appearance

For those who wish to file a written statement for the printed record of the hearing, five copies are required and may be submitted to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102 Longworth House Office Building, Washington, D.C. 20515, by close of business, July 1, 1983. An additional supply of statements for the printed record may be furnished for distribution to the press and public if supplied to the Committee office before the hearing.

Chairman RANGEL. The hearings of the Oversight Subcommittee of the Ways and Means Committee on private foundations will come to order.

Present rules covering the tax treatment of private foundations were enacted as part of the Tax Reform Act of 1969. The private foundation provisions of the 1969 act were enacted in light of findings that neither the general requirements for tax-exempt status, nor the specific rules under prior law governing foundation transactions and expenditures, had proved effective to insure that Federal income tax benefits would be available only where a foundation's assets and income are devoted to charitable purposes. Accordingly, the 1969 act established new rules and excise tax sanctions.

With limited exceptions, there has been no comprehensive review of these provisions by the Committee on Ways and Means since their enactment in 1969. At the request of the chairman of the Committee on Ways and Means, Dan Rostenkowski, the Subcommittee on Oversight today begins 3 days of hearings on Federal law private foundation rules and related issues. The hearings are intended to develop information that will assist the subcommittee in evaluating the provisions of present law. Specifically, the subcommittee is interested in determining whether the present foundation rules, without imposing unnecessary or unduly burdensome restrictions, insure that only those private foundations operating for the public benefit enjoy favorable tax treatment.

In recognition of the special role private philanthropy plays in our society, Federal tax policy is designed to encourage private charity. Therefore, the subcommittee is also seeking information on the following general questions:

What role do private foundations play in private philanthropy?

What philanthropic activities are private foundations undertaking and who are the recipients of their charitable distributions?

How are private foundations responding to the President's call for increased voluntarism and private sector initiative in light of reduced Federal spending?

And what is the value of foundation assets, what types of assets do they hold, and what is the level of foundation charitable distributions?

In the 98th Congress, a number of bills have been introduced to modify various private foundation rules or to provide exceptions to particular rules. For example, many bills would provide special exceptions to present law rules which limit private foundation business holdings. While these bills are not specifically the focus of the subcommittee hearings, as part of its review of the rules which govern private foundations, the subcommittee is seeking comments on the policies which underlie present law.

Initially the subcommittee scheduled only 2 days of hearings, Monday, June 27, which is today, and tomorrow June 28. However, an additional day, Thursday, June 30, has been added in order for the subcommittee to fully explore with invited witnesses and those who have requested to be heard all the issues relating to private foundations.

However, because of the large number of witnesses scheduled to testify each day, the subcommittee will observe the 5-minute rule with regard to witness statements and members' questions. I also would want to announce that, because of the heavy schedule in terms of invited witnesses and requests for witnesses, tomorrow's hearing will begin at 9 a.m. rather than at 10 a.m.

Mr. Conable, the ranking member of the Ways and Means Committee, is recognized.

Mr. **CONABLE**. Thank you, Mr. Chairman.

As ranking member, of course, I am only an ex-officio member of this subcommittee. As usual I am muted and glorious in the face of such an opportunity, but because of a special interest in the foundation field I would like to make an opening statement.

This hearing marks the beginning of another chapter in the history of private foundations in the United States. It is the first comprehensive review by a congressional committee of the status of foundations and the impact of the 1969 Tax Reform Act since that landmark legislation was enacted 14 years ago.

We have a lot to review in these hearings in terms of how foundations have fared since 1969 and how well the 1969 legislation has operated.

Last year I served on the President's Task Force on Private Sector Initiatives. My task was to review legal and regulatory impediments to private philanthropy. This review reinforced my awareness of the important role foundations play in supporting charitable endeavors, a role far larger than their $4 billion gifts annually would indicate.

As an example, I would like to enter into the hearing record following my statement, Mr. Chairman, two articles about fundations in Rochester, N.Y. The first describes the initiative taken by the Gannett Foundation in studying community needs, designing a program to respond to those needs, soliciting the cooperation of community leaders and agency directors and in funding the new program. Second, the Daisy Marcus Jones Foundation in providing small grants and seed money to innovative projects.

The Task Force on Private Sector Initiatives last year devoted considerable attention to the response of private philanthropy and the for-profit sector to public needs. One of the conclusions we reached was that it was unrealistic and inappropriate to expect foundations, public charities and businesses to fill the gap resulting from Federal budget constraints. I expect that during these hearings we will hear many inspiring examples of how private foundations and their grantees have indeed responded to the serious problems and human needs evident in the recession.

But I want to state here at the beginning of these hearings that I do not think that it is at all clear that all cutbacks of Federal spending ought to be replaced with private or philanthropic contributions or that private foundations ought to be expected to bear a disproportionate part of the burden of responding to the results of the economic cycle.

Another conclusion reached by the task force was that there appear to be a number of impediments which reduce the effectiveness of foundations or needlessly curtail their philanthropy. Remedies are proposed in H.R. 3043 which I introduced last month together with Mr. Shannon, Mr. Frenzel, and Mr. Gephardt, our colleagues here on the Ways and Means Committee. I am pleased that the announcement of this week's hearings asks witnesses to focus on problems addressed in our bill.

I expect this to be an informative set of hearings, Mr. Chairman, I am confident that the record we create here this week with testimony, statistics, and studies will provide a valuable tool to aid in the assessment of the well-being of private foundations. It will guide us in ways in which the committee can help foundations continue their important philanthropic work with a minimum of hindrance from unnecessary or discriminatory rules which either serve no purpose or which have outlived their usefulness.

I see quite a few faces in the room, and I look forward to hearing the information to be presented today. I would like particularly to express pleasure at the presence of our former chairman, Wilbur Mills, who has forgotten more about private foundations than I will ever know.

Mr. Chairman, thank you for letting me make this opening statement.

[The articles referred to follow:]

[From the Sunday Democrat and Chronicle, Mar. 20, 1983]

DAISY MARQUIS JONES

THE WOMAN

(By Vaughn Polmenteer)

The very name elicits curiosity.

Every week on WXXI-TV, Channel 21, the name flashes across local television screens: A program is brought to you by a grant from the Daisy Marquis Jones Foundation. The name appears frequently in local newspaper stories: The Daisy Marquis Jones Foundation has helped to fund one community service or another.

It's an unusual name and a melodious one, which accounts for part of the curiosity and the mystery.

Who was Daisy Marquis Jones?

That's not the easiest question to answer.

People who knew her will tell you no one knew her well. And today, 11 years after her death, she remains something of an enigma.

Daisy Marquis Jones was a private person. There is even some doubt as to her exact birthdate, though Feb. 26, 1887 is the supposed one. She spent her childhood days in Pennsylvania, the daughter of Joseph and Rose Marquis. Her father sold equipment to oil well drillers and operators—a lucrative business during the oil boom days.

During the 1920s she moved to Rochester, to Wilmer Street, off Monroe Avenue.

Daisy was an attractive woman, but she remained single, not marrying until late in life when she was in her 50s. Her life-long passion was something other than romance.

Daisy had some money from her parents and by the time she was in her 20s she was already well into doing what she did well—making more money.

"She lived modestly," says Pearl Rubin, director of the Daisy Marquis Jones Foundation. "She preferred to save her money and to invest it wisely, and I might say astutely. . . She was an independent and strong-willed woman."

Daisy's investments included such blue chip standards as Eastman Kodak and Mobil Oil as well as other, more exotic ventures like a water reservoir in Puerto Rico.

Daisy kept a very, very low profile. Few people in her Monroe Avenue neighborhood had any inkling that the retiring woman, who dressed modestly but well, was becoming a millionaire several times over.

"But she was a well-known figure among the bankers and the brokers of the downtown area," Pearl Rubin says. "And she could give and take with the best of them. She had their admiration and respect as an investor, a business person, but more importantly, as one who cared about people."

During her lifetime Daisy was intensely interested in health care—discretely donating money for research and hospital facilities. That interest would later become a key concern of her foundation.

In the 1940s Daisy married J. Nelson Jones, owner of Bell-view Farms Dairy in Himrod, Yates County. She moved into the country to help him run the farm. Daisy loved horses and loved to ride. She was "quite a horsewoman," one relative recalls.

And she became attached to the small rural community of Himrod. In 1961, she gave her neighbors a firehouse and fire equipment—generous gift. But still, nobody in Himrod had any idea that Daisy was a wealthy woman.

J. Nelson Jones died in 1961. Daisy stayed on at the farm for a while, then moved back to her Wilmer Street house—still investing and giving. Her concern for Park Avenue Hospital—later Park Ridge Hospital—prompted her to give it $1,000 a month for the duration of its building fund campaign. She promised to leave the hospital $1 million in her will—and she did.

Daisy died on Sept. 14, 1971 in the Brightonian nursing home, leaving an estate of $12.2 million; $3 million was stock in Lone Star Gas of Texas.

It wasn't an outrageous fortune but a handsome one. Daisy was childless, and the bulk of her estate went to the Daisy Marquis Jones Foundation, which she had set up in 1968.

There was a mixed group of other beneficiaries: Houghton College, Keuka College, the YMCA, the Jewish Home and Infirmary, a Honeoye falls youth center, Opera Theater of Rochester, the Regional Council on the Aging, the Penn Yan Soldiers and Sailors Hospital, the National Center for Dispute Settlement, an adolescent maternity program, a grant to Sonnenburg Gardens for the admittance of elderly people, an intercommunity medical building in Attica. There were also small bequests to some relatives.

Daisy's surviving relatives are as reticent and as retiring as she was, and they say they remember very little about her. But her nephew, Leo Lyons, recalls driving her to banks and to doctors' offices, and he does remember her as "very acquisitive. Everything she bought, she held on to and just waited. And most of the time, of course, she was right."

And Lyons remembers one family anecdote:

"She was living with relatives in Pittsburgh at the time. She had a little money saved. And the relatives said they had some good information on a stock, so she went to a broker and invested her savings.

"That night, she got cold feet. The next day she went over to the broker's with the idea of pulling out. He saw her coming and met her and said, 'You got $250 in profit on your stock. You want to sell it or keep it?'

"That started her off," Lyons says.

Daisy was then only 15.

THE FOUNDATION

Ascend to the ninth floor of the Four Corners Crossroads Building, turn right from the elevators and walk to the end of the hall. This is where you'll find the offices of the Daisy Marquis Jones Foundation.

If you expect a suite of offices—mahogany walls, a wet bar, a convex conference table—you're in for a surprise. The foundation gives away $1 million a year to organizations in Monroe and Yates counties. Yet it operates out of two tastefully decorated, but extremely modest rooms.

Walls in the outer office are covered with testimonials from the American Cancer Society, Friends of Education and other groups the foundation helps fund. A Channel 21 County Auction calendar is taped to the wall, near a file cabinet and a coffeemaker. This office is often empty; the secretary only works part-time.

The inner office—decorated in muted blues—has a desk, three chairs, a few prints, and a magnificent view north, across downtown, to the Kodak office complex.

Daisy Marquis Jones' foundation lives as unpretentiously as she did.

Running the roost is director Pearl W. Rubin—a gregarious, droll and eloquent woman. She works with four trustees—Leo M. Lyons (Daisy's nephew), Sydney R. Rubin (Pearl's husband), Helen G. Whitney (Daisy's grand-niece) and a representative of Marine Midland Bank. They are the Daisy Marquis Jones Foundation.

The foundation was set up in 1968 by multimillionaire Daisy Marquis Jones. It was designed as a vehicle for philanthropic work during her lifetime and afterward. When she died in 1972 the bulk of her $12.2 million estate poured into the foundation.

The capital assets of the foundation fluctuate with the economy. Its current net worth is around $14.7 million. Grants are made from profits on investments—the capital monies are never tapped. "Daisy was a wise investor, and so is the foundation," Pearl Rubin says. "Never touch the capital."

On Channel 21, Daisy Marquis Jones has funded such shows as Agronsky & Co., Over Easy, Wall Street Week and Here's to Your Health. But only a tiny portion of the foundation's money goes to public TV.

In 1981, $1,353,200 was disbursed or pledged to 105 grant recipients; Channel 21 received $38,924—hardly the lion's share.

The foundation's money goes to an extremely diverse group. "The major grants still go to hospitals," Rubin says, noting that this reflects Daisy Marquis Jones' interest in health care. "But she left a broad charter to the foundation."

The following examples from a list of 1981 grant recipients underscore that diversity: Al Sigl Center, $25,000; Eastman Dental Center, $10,000; Baden Street Settlement, Inc., $3,000; a grant of $5,000 to Chuch Women United for a women prisoner's halfway house; Regional Council on the Aging, $2,709; Yates County Firewood Program, part of as alternative energy program for low-income rural residents, $12,500; Volunteers of America men's residence kitchen, $10,000.

The largest grant that year went to Keuka College—$125,000 for a scholarship fund and capital improvements. Another $100,000 went to the Center for Governmental Research for research into community human services needs.

Who decides who gets the money and how much?

Pearl Rubin is the wife of Sidney Rubin, who was Daisy's lawyer at the time of her death.

Initially, Pearl informally helped the trustees make decisions about what should be funded. They valued her advice because she had worked with many organizations in her career as a school psychologist.

By 1975, it became obvious that the foundation needed a full-time director, and she was appointed.

"Nobody told us how to do this job," Pearl Rubin says. "We meet every month and have some *very* heated discussions about what to do with the money . . . It takes a lot of analysis, of sifting the facts. I call a lot of people I know—service providers, consumers—and get a feeling for what the program is really like. Everybody (among the trustees) really *cares* where the money goes."

The foundation doesn't fund individuals, basic research, the arts, religion or political activities. Its basic philosophy, Pearl Rubin says, is to "complement" other funds. "There's an emphasis on the disadvantaged, on self-help programs. Self-help and independence for people. We try to be a catalyst and bring elements of the community together."

An example, Rubin says is the Family Support Volunteer Project of the Volunteer Forum of the Red Cross. The program established a central recruitment and training program to provide volunteers for families "at risk" of child abuse.

The foundation makes no long-term, year-to-year commitments. This flexibility, Rubin says, allows the Daisy Marquis Jones Foundation to give grants to groups that other foundations might overlook.

One of those groups is the Vietnam Veterans' Outreach Center on South Avenue.

The center provides counseling for veterans suffering problems stemming from duty in Viet Nam. When the program first started in 1981, funds were scarce.

"We went out begging, knocked on doors," says executive director Tom Cray. "Pearl (Rubin) took a special interest in us, and Daisy Marquis Jones approved a grant for $25,000."

A year later, when the program was in danger of shutting down for lack of funds, the foundation gave another grant of $10,000. Today the outreach center operates with a mix of funding, including some from the Veteran's Administration.

The relatively small grants to the outreach center are typical grants, Pearl Rubin says. "It's the little projects that are the most fun to help.

"Some of them (other foundations) are scared to death and they forget why they exist. But this is a private foundation, and it doesn't have to worry about a corporate image. It can afford to take a chance, to take risks."

"We were a risk," Tom Cray agrees. "Almost nobody wanted to touch us. Everybody wanted to ignore Viet Nam and ignore the veteran.

"But on two separate occasions, the seed money to keep the agency going came from the Daisy Marquis Jones Foundation. They believed in us."

[From the Rochester (N.Y.) Democrat and Chronicle, May 7, 1983]

How Rochester Solved Housing Problem

(By Michael J. McManus)

Mrs. Raymond French, 56, was desperate.

Her uncle, Raymond Hightree, 87, a retired Eastman Kodak Co. graphic artist, was home after a stroke and three months in the hospital. He is mobile, but fragile. And he lives alone in a two-story house that he built a half century ago—that he does not want to leave.

But Mrs. French recalls with horror that after his stroke, "he lay for four days before I found out what happened. I called once and there was no answer, but I assumed he was out shopping."

With her own family to care for, Mrs. French felt she had to find someone to help him.

Her options were limited and expensive.

A nursing home would cost $72 a day in a private room, or $71 in a semi-private room! "It would not take long for his savings to go at that rate," she said. So she advertised for someone who would move in, and simply be with him, perhaps fixing an evening meal. Those who called wanted $200 to $300 a week plus free room and board.

"I couldn't believe it!" she said. "There must be people out there who need homes who'd be willing to exchange their services in order to get free room and board. But I don't know where they are."

Last month a "Shared Housing Opportunities Program" (SHOP) began in Rochester that is pledged to "help senior citizens maintain their independence by sharing their housing costs with another person," as Eugene Kramer of the Housing Council in the Monroe County Area, Inc., put it.

"And there is considerable interest on the part of young adults who are looking for home-sharing as an answer for their own needs. We'll put together a pool of 50-60 such people so that Mrs. French has a real choice that she could never get on her own.

"SHOP will provide more disposable income to the elderly by reducing their housing costs, plus better companionship and security for those living alone. It will also make more effective use of the existing housing stock. And it will reduce the demand for costly support services and institutional care. SHOP will screen interested people, help make an appropriate match, and give counselling assistance."

And the program would not exist today if it were not for the concern and initiative of the Gannett Rochester Newspapers—and the generosity of Frank Gannett, founder of a newspaper empire. He gave nearly half of his estate to create Gannett Foundation.

It was a Gannett Foundation grant of $35,000, and grants of $36,000 from the Marie C. and Joseph C. Wilson Foundation; $25,000 from the Daisy Marquis Jones Foundation and $5,000 from the John F. Wegman Foundation, which is creating the innovative SHOP project. However, unlike most foundation grants, the idea for the grant did not come from the agency that received the grant.

Where did the idea come from?

Frank Gannett always returned some of his newspapers' profits to the communities served by the papers. After he died, that tradition continued with stock he willed to the foundation. Last year the foundation gave away more than $10 million, including $5.7 million recommended by the various newspapers, TV and radio stations to help meet community needs. But all of those grants were in response to requests.

Last year the foundation decided to commit an additional $1.25 million "to have a major impact on serious community problems," said Eugene C. Dorsey, the foundation's president. The papers had to develop the proposal themselves, and each had to be accompanied by a thorough "ascertainment of the problems in their community."

To prepare the ascertainment, Gannett Rochester Newspapers Publisher George J. Dastyck and Barbara Biben, director of the newspapers' Public Service and Promotion Department, invited recommendations from community leaders and directors of agencies meeting the area's human service needs.

Both groups independently concluded that one of the area's major problems was a shortage of affordable housing—especially to meet emergency needs.

The consensus was that the nonprofit Housing Council was the logical agency to take on the task, so Eugene Kramer got a call asking him to apply for a grant. He was flabbergasted: "Usually you have to go pounding on people's doors to get any funding," he said. "Here was a funder who had carried on the research and came to us!"

Gannett Foundation contributed $75,000 to the Housing Council. The portion not going to the Shared Housing Opportunities Program will be used to help find permanent housing for homeless people, Kramer said.

Newspapers' greatest contribution to a community may be found in the daily product. But it is refreshing to see that some of the profits are being returned too, and as creatively as they are in Rochester.

Mr. PICKLE. Mr. Chairman.

Chairman RANGEL. Mr. Pickle.

Mr. PICKLE. May I add my welcome to Chairman Mills. Many years ago when I was a member of the Texas Employment Commission I would come to Washington and I would testify and sit down there and look up at this man with the gavel. I always hesitated to ask questions, said the minimum and wondered what would happen next. Usually the Chairman would engage us in pleasant conversation rather than hard questioning. This morning we have the Chairman testifying before us; the situation is reversed, and it is a pleasant reversal. Mr. Chairman, I believe this is one of your first visits to testify before the committee that you chaired so magnificently for so many years.

It is a personal pleasure for me to welcome you here. I have an interest in the broad spectrum of foundations, as all of us do. I have a particular concern with the question of whether these foundations should be able to own independent newspapers but that is another question, and we will get to that.

We welcome you here.

Chairman RANGEL. Our first witness this morning is the former chairman of the Committee on Ways and Means, Wilbur Mills. We thank you for the great contribution that you have made to our Nation and certainly for the historic contributions you have made to the Ways and Means Committee in writing the Nation's tax laws.

We welcome you and we will be pleased to have you share your views with us.

STATEMENT OF HON. WILBUR D. MILLS, COUNSEL, SHEA & GOULD, WASHINGTON, D.C.

Mr. MILLS. Thank you very much, Mr. Chairman. I want to thank you for your welcome, and Mr. Conable and Mr. Pickle as well.

I am pleased to be given the opportunity to provide you with some background on the events and atmosphere that led to the Tax Reform Act of 1969, especially as it affected private foundations.

As you know, private foundations have never been a favored vehicle for charity on Capitol Hill. I think this is true in part because many people do not understand foundations or how they work, and most of us have a natural suspicion about anything we don't understand.

But more than that, we in the Congress during the 1950's and 1960's were receiving a constant stream of adverse reports and accusations about the illegal activities and alleged tax abuses of foundations. And some of those reports, especially in the early years, were accurate.

Private foundations have been a popular target for congressional investigations ever since they began to increase in number after World War II. In fact, in 1947, the Ways and Means Committee held one of the first hearings on charges of unfair tax advantages gained by private foundations through business income that was unrelated to their charitable purposes. There was also testimony on certain sale and lease-back transactions between a corporation and a foundation that were tax abusive.

During those early years we also learned from various reports and investigations that some private foundations were simply extensions of their founders, to be used for their benefit and not for any charitable purpose.

The Revenue Act of 1950, as it applied to foundations, was a direct expression of our concern for the abuse of the Federal tax system by private foundations. As finally adopted, the Revenue Act of 1950 aimed to eliminate a number of abuses, including an unreasonable accumulation of income and the use of foundation income for non-tax-exempt purposes.

You may not have been on the committee in the 1950's, but I am sure you recall the climate of those times: the Red Scare; McCarthyism; loyalty oaths, and so on. Curiously, private foundations also came under suspicion at that time, on the basis that foundations were supported by persons tending to favor Marxist socialism.

In April 1952, a House resolution authorized a committee, but not the Ways and Means Committee, to conduct an investigation of foundations to determine whether their resources were being used for purposes other than those for which they were established. In particular, the investigation was designed to determine which foundations were using their resources for un-American and subversive activities.

The committee was led by Congressman Cox of Georgia, and was granted a short life of 8 months to issue a report. The committee report, on balance, favored private foundations and, in fact, praised foundations for significant services to society. The Cox committee reported that there was little basis for allegations that foundation funds were being diverted from their intended use. No evidence was found indicating any infiltration by subversives or supporters of the Communist system. However, despite the clean bill of health from the Cox committee, the Congress created another committee to investigate foundations the following year. This committee, chaired by Congressman Reece of Tennessee, also was authorized to investigate un-American and subversive activities as well as political activity, propaganda, and attempts to influence legislation.

Hearings were conducted in 1954, but foundations were permitted to submit only written testimony. The majority report of this committee was extremely antagonistic toward foundations. It was not surprising that additional restrictions on foundations were added when we adopted the Internal Revenue Code of that same year, 1954.

These continuing investigations in the 1950's into abuses and allegations linking private foundations to the Communist movement could not avoid having an impact on Congress. However, I think the single greatest influence on Congress leading up to the 1969 act was Congressman Wright Patman of Texas. I don't know why, he never told me, but Wright Patman disliked and mistrusted private foundations. In 1961, Congressman Patman announced, on the floor of the House, that he had begun an investigation of foundations and would report his findings from time to time. Nearly every year, from 1961 through 1969, Mr. Patman issued a report to the Congress either alleging abuses by foundations or recommending further restrictions on private foundations.

I say "nearly every year." Congressman Tom Curtis tried to get Mr. Patman to refer the investigation to a committee, preferably the Ways and Means Committee, but Mr. Patman would have none of that. In 1962, Mr. Patman chaired the Select Committee on Small Business and he created a special subcommittee on foundations. What is interesting about Congressman Patman's reports—he issued 8 of them over a 10-year period—was that the reports were not from a subcommittee to a committee or even from a full committee to the House. His reports were from the chairman of a committee to his committee. As such, they were his personal opinions and recommendations.

The first of these reports heavily criticized the Treasury Department and the IRS for their "laxness and irresponsibility" and their "splendidly ineffective supervision" which, he said, allowed charitable foundations to be used for tax avoidance.

Some of his recommendations included limiting the existence of all foundations to 25 years, setting up a regulatory agency for the supervision of tax-exempt foundations, and prohibiting foundation involvement in business. There were no hearings at which foundation representatives could defend their position. Other members of the subcommittee did not participate in the investigation and these members objected vigorously to Mr. Patman's procedures.

The initial Patman reports, issued in 1962, 1963, and 1964, undoubtedly influenced us and caused myself and the chairman of the Senate Finance Committee to ask the Treasury Department to prepare a special report on private foundations. That report, issued in 1965, was in fact the basis for the Tax Reform Act of 1969 as it applied to foundations.

In the midst of the Patman reports, the Revenue Act of 1964 was passed and contained provisions which continued to discriminate between private foundations and publicly supported charities. For example, we increased from 20 to 30 percent the amount of deductible contributions individuals could make to charities. However, we excluded from the increase donations made to private foundations, which were continued at the 20-percent ceiling.

So, in 1969, the Ways and Means Committee members were very much aware of the congressional interest in foundations. In fact, the first witness at our hearings on private foundations in 1969—as Mr. Conable will remember—was Wright Patman.

But there were other factors that influenced us in 1969. There was a general acknowledgement that the American people were growing increasingly unhappy over inequities in the tax burden.

There was a perception that many people with high incomes were paying less than their fair share. Reform was in the air.

In fact, the Revenue Act of 1968 directed the President to submit recommendations for comprehensive reforms to the Congress, and when President Johnson decided not to submit recommendations because he was leaving office, Senator Russell Long and myself asked President Nixon to do so. There was a general feeling that reform was needed.

We had 4 days of hearings on private foundations and it resulted in nearly one-fifth of the 1969 Tax Reform Act being devoted to additional restrictions on private foundations.

During those hearings several new concerns of the members came to light. There was a belief that foundation money had been used to help register voters in specified cities or counties and so had caused or prevented the election of certain candidates. The criticism was that the foundation, by selecting the exact location where money was to be spent for voter registration, influenced the election results.

About the same time, there were newspaper accounts that some officials had accepted important government positions with the understanding that they would be reemployed by foundations upon their departure from office. This contributed to congressional suspicion that foundations could find ways to unduly influence governmental decisions.

Another spark in 1969 was the disclosure that certain foundations had given grants for "travel and study" to several members of a campaign staff. Certain members of Congress were outraged at the grants because they could not see any intellectual benefit flowing from them. All of these factors were bound to have an emotional effect on the deliberative process of reforming the taxing statute.

From a "conservative" viewpoint, foundations were too much engaged in social change. For example, voter registration among minority groups. From a "liberal" perspective, foundations were seen as extensions of big business and more concerned with their own influence than with charitable needs. There was also popular suspicion of concentrations of wealth alleged to have been "extracted at the expense of working men and consumers."

In this charged atmosphere foundations naturally became a target for reform.

I believe we acted in good faith in 1969 and I believe on the whole we did a good job. But I think enough time has passed to look again at the whole foundation area and judge whether adjustments are needed.

I thank you and your chairman for inviting me back and giving me the opportunity to appear before you.

It is a pleasure to get to see you all and to be here. Thank you.

Chairman RANGEL. Thank you, Mr. Chairman. I don't believe in all my years in Congress have I heard such an unbiased, objective statement being given by a witness. I checked swiftly and I see that you will testify tomorrow and perhaps we can get the benefit of some of your specific views.

Having had the opportunity to review what the Congress has done under your leadership, do you have any specific recommendations for the tax-writing committee now?

Mr. MILLS. I don't have, except I will appear, Mr. Chairman, tomorrow with a witness who is endeavoring to establish a foundation and has found that he cannot quite complete it because of a provision of the 1969 law. I know I never intended to make that provision as tight as I did; the foundation is a very worthwhile foundation for the very worthwhile purpose of medical research.

Chairman RANGEL. Our subcommittee is to provide oversight, of course, but we, also would want to correct those errors that were made when it was not the objective of the legislation. But, in a broad sense, are you satisfied with the distinction between public charities and private foundations and do you believe that should be maintained?

Mr. MILLS. Insofar as I know, Mr. Chairman, let me say this first. There was a feeling at that time that I hope has been eradicated and eliminated from the public mind about foundations.

I don't know of any abuses that caused these hearings to be called or any scandals or anything of that sort. There was that fear in the air through the 1950's and 1960's. I think it has been eliminated.

I don't know of any reason for maintaining the difference between contributions to public charities and contributions to foundations. I know of no reason why it should be continued, frankly.

Chairman RANGEL. Do you believe, in view of President Reagan's call that the private sector should be doing more, that charitable organizations are able to meet the call of President Reagan to try to fill in the shortfalls after withdrawal of Federal support in certain areas?

Mr. MILLS. I would think you would get far more information if you talked to people engaged as managers of foundations. I frankly don't know.

But from a general knowledge about it, I think the foundations are doing the maximum they can do. They are permitted to accumulate earnings in excess of 5 percent if they want to, but sometimes those earnings are paid out, and no doubt in some worthwhile activity.

There is a limit, of course, to what they can do to match a need that may be far greater than the foundation is able to meet. But by and large, I think they are doing an excellent job to the extent that their resources will permit them to do.

Chairman RANGEL. You testified about the climate in which the 1969 provisions were passed. Now that things have been relatively cooled off, do you believe that voter registration is a proper function of foundations?

Mr. MILLS. It never bothered me at the time. I was not one who objected to it at that time.

I mentioned it because some Members of Congress were concerned that if foundations registered voters in only certain areas, not nationwide, that they would affect the return and the election in that particular area. That was the point.

No, I have no objection to foundations using moneys generally to bring about voter registration. I was always very active in getting people registered in my own State.

Chairman RANGEL. Of course, one of the things that you are well known for is your longstanding belief that the tax system should be used to encourage certain types of behavior, and certainly charitable activities were that sort of behavior that the Nation encouraged and certainly that you encouraged as chairman of Ways and Means.

I assume you would want us to continue to do that. But are there any specific recommendations that you are prepared to make at this time or at a later time that might be able to expand the charitable activities of foundations and to make it easier for people to contribute to these organizations?

Mr. MILLS. I don't know that I have any specific suggestions. I am not as fully aware of the entire operation of foundations today as I was when I was sitting in your chair.

If you will give me the opportunity, I will try to provide you with an answer to the question for the record.

Chairman RANGEL. We would welcome you making yourself available to this subcommittee to give us some guidance and assistance as we reach those sticky points in trying to bring some balance to this system. I would want to compliment you for giving us this unique type of perspective that you have on the background and the conditions under which you legislated.

Mr. Conable.

Mr. CONABLE. Thank you, Mr. Chairman.

Mr. Chairman, as I recall the 1969 deliberations, I recall we spent a good deal of time on the issue of divestiture.

Mr. MILLS. Yes.

Mr. CONABLE. There was a good deal of concern about the smaller foundations setup with the idea of preserving control in perpetuity for business organizations—closely held but large illiquid financial assets which otherwise would have to be sold for payment of estate taxes. We have greatly relaxed our estate tax environment since that time.

I just wonder if generally you have been satisfied with the operation of that divestiture law?

There have been some 15,000 corporations that have gotten rid of excess business holdings since the 1969 act, but it continues to be a troublesome matter and plays a substantial role in the organizing of these hearings, simply because there were some foundations which felt they had special reasons for wanting to continue the exemption, which, as you recall, we left in place for a number of years, in most cases, in the event there was a very substantial concentration of ownership in one company or in one family.

Have you been generally satisfied with the operation of that law for the intervening years?

Mr. MILLS. So far as I have been able to keep up with it, I have, Mr. Conable.

I am not as aware—I repeat—of what is going on today as I was when I sat on the committee. I have not had occasion to keep up with the operations of them. I don't hear of scandals or abuses.

It is significant to me that we don't hear of those abuses or scandals. We must have been effective to some extent in the 1969 act.

On the termination matter, I have never favored the suggestion of Mr. Patman of requiring all of them to terminate within a 25-year period. I thought foundations served a useful purpose, and if they were not on the proper road, then it was proper for Congress to set them on the right road.

But by and large, the people I have met and talked to who do operate foundations are very honorable people, very fine people who are interested in doing the maximum good for society with the assets that they have.

Mr. CONABLE. Am I correct that that was a major concern of the committee?

Mr. MILLS. Oh, absolutely it was. It was then, yes. It was because of all the things that were being said by people at the time.

Mr. CONABLE. Thank you, Mr. Chairman.

Chairman RANGEL. Mr. Pickle.

Mr. PICKLE. I thank you, Mr. Chairman.

I want to thank you, Chairman Mills, for your statement and a good background and a feel for what has happened in years past. It is helpful to the committee.

If you do have any recommendations to suggest as we go forward in the next few days, we would like to have them.

I take it from your testimony that in general you agree that the Reform Act of 1969 and the administration of those laws has proceeded in a manner consistent with congressional intent.

I assume that is generally your position; is that correct?

Mr. MILLS. That is correct.

Let me repeat, if I may, I want to commend the committee for looking into the matter. I think the Congress has a responsibility to review statutes every so often to see whether or not the intent of the Congress is being carried out not only by the departments of Government that manage the law, but those who are subservient to the law.

In this case, I would check back to see if the intent that we had in 1969 is actually being carried out. So far as I know, it is. Ask, "Did we eliminate all the abuses we intended?" If not, let's eliminate the rest of them. "Did we make provisions too restrictive?" If so, let's ease them to allow other foundations to operate. If they happen to get on the wrong road, some road we don't want them on, let's put them back on the right road.

But so far as details of the operation, I don't have those in mind like I used to. But I can think in terms of broad objectives, and these would be the broad objectives I would have in mind.

Mr. PICKLE. Thank you, Mr. Chairman.

Chairman RANGEL. Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman.

I would also like to welcome our former excellent chairman to the committee, and also Professor Karl, who is with him.

Mr. Mills, do you think the concerns regarding the operation of the foundations that were so prevalent in the years leading up to the enactment of the Tax Reform Act of 1969 are relevant today?

Mr. MILLS. I don't think so. I think practically all the abuses we ran into have been eliminated. I have heard of none.

Certainly we have heard of no scandals or any outstanding examples that we didn't intend to permit. They just don't exist today, apparently.

Mr. DUNCAN. Do you see a trend away from private establishment of these foundations?

Mr. **Mills**. No. I have talked to people in the foundations and I find them to have a very sincere desire to serve society, to serve the public. But I don't get to talk to a lot of them, of course.

Mr. **Duncan**. Thank you, Mr. Chairman.

Chairman **Rangel**. Mr. Thomas.

Mr. **Thomas**. Thank you, Mr. Chairman.

I, too, want to welcome the former member of this committee. This member from California certainly feels the lack of historical perspective in dealing in this area of the law. My understanding is only three current members of the Ways and Means Committee were present in those 1969 hearings.

The chairman indicated that in those 1969 hearings, the first witness was Wright Patman, and that tended to set the tone of the hearings. I would only hope that in noticing that the first witness at these hearings, Hon. Wilbur Mills, based on his testimony, I hope that sets the tone for these hearings.

I thank the chairman for his setting the tone for these hearings.

Mr. **Mills**. You are very kind, sir.

Chairman **Rangel**. The Chair would recognize Mr. Karl, Norman and Edna Freehling Professor of American History, University of Chicago.

STATEMENT OF BARRY D. KARL, NORMAN AND EDNA FREEHLING PROFESSOR OF AMERICAN HISTORY, UNIVERSITY OF CHICAGO

Mr. **Karl**. Thank you very much. I would like to compliment——

Chairman **Rangel**. If the gentleman will yield—Mr. Martin, do you have any questions?

Mr. **Martin**. Mr. Chairman, I have no questions. I would just say that the gentleman from California in his juniority did well in expressing the sentiments of all of us as to the former chairman of this committee.

Mr. **Mills**. Thank you, Mr. Martin.

Chairman **Rangel**. Professor.

Mr. **Karl**. I would like to compliment Mr. Mills. As a fellow historian, he did an excellent job of providing background for what we who have gone into the record of the 1969 experience have discovered.

I would like to stretch that perspective a bit, because I think there is a somewhat lengthier history that will serve as additional background for you.

The American philanthropic foundation has been a subject of periodic controversy ever since creation of the first foundations in the first decade of the 20th century.

John D. Rockefeller originally requested a congressional charter for his foundation and Congress, after a lengthy debate, rejected the idea. By 1915 a commission appointed by President Wilson to investigate industrial unrest raised critical questions about foundation activities, and in the decades that followed, foundations have come under scrutiny at 10 to 15 year intervals, the degree of acrimony varying from instance to instance, but the basic issues remaining pretty much the same.

It might be useful to spell them out, since there are probably few instances that parallel the rather remarkable discrepancy between the purpose announced by the initial foundations—their devotion to the welfare of mankind—and the problems so often perceived in their activities.

Foundations came into existence at a point in world history when all industrialized societies were beginning to question the ability of traditional governmental forms to deal with the social and economic effects of industrialization.

At the same time, scientific discoveries were already making it clear that our abilities to preserve life and to destroy it were on a collision course and proceeding at breakneck speed. This was at the turn of the century, well before the dawn of the atomic age, but at a point where discoveries in medicine suggested revolutionary cures for all human diseases, while inventions in locomotion and explosives promised warmaking capabilities on an escalating scale.

Figures as far apart on an ideological spectrum as Pope Leo the Thirteenth and Karl Marx were calling on industrial societies to recognize the perils they faced and to reshape their conceptions of governmental responsibility for dealing with them.

For Americans such discussions took place within the context of a long history that rejected centralized national programs for coping with national problems. The limited role of the Federal Government was viewed as a protection of State and local responsibilities for the welfare of citizens.

President Franklin Pierce had vetoed a bill in 1854 that would have created a national program for dealing with the mentally ill. The language he used became the catch phrase of all such defenses: that a Federal program would "dry up the well-springs" of local charity.

Subsequent efforts to introduce Federal involvement in the education of the young faced similar rejection over the next century, while other societies, recognizing the need to educate succeeding generations as one of the fundamentals of human survival, developed various national programs.

In an important sense, the first modern foundations were an effort to establish national programs that would face such issues, not by providing direct support to local communities as charity, but by giving communities encouragement to help themselves with partial gifts to entice local contributions and, equally important, by providing them with carefully worked out programs based on the latest scientific knowledge and research to use as models for their own development.

The specific rejection of charity as a method was part of that generation's revolution. They wanted to find root causes of poverty, to end the palliative measures they believed only perpetuated the evils that they wanted to wipe out.

By the 1920's, foundations had developed for themselves a model of behavior that can be described quite easily. By organizing and developing new methods of coping with social problems, they could provide experimental resources that would enable communities to see what might be useful to them and then to adopt them for themselves.

The idea was that local governments would not have to bear the cost of experiments but would then be able to select and pay for the proven workable services themselves, while foundations would move on to other experiments.

One of the earliest such ideas was the Carnegie library, which involved the gift of the building, but required the community to provide the books and the management. Similar arrangements gave the new family and juvenile courts the opportunity to see if social workers in the courtroom would help families deal with the law. There are numerous examples of this.

My favorite one is the Guggenheim Foundation that offered to help paint direction signs on rooftops and in open fields to aid early airplanes in finding their way from one city to another.

The principle was always the same. Foundations were there to help find the way; but public responsibility, either in the form of matching funds from other philanthropists or in the assumption by local government of financial responsibility, was to be the ultimate end. This was a realistic appraisal, too, of the limits of foundation resources and a judgment of the best uses to which such funding could be put.

The method reached its zenith, perhaps, in the 1920's and 1930's. Herbert Hoover became its champion, using foundation funding to provide economic research ideas for the Nation's business during his years as Secretary of Commerce, and then working to organize foundation support for programs during his presidency.

He had had experience with the idea which went back to his wartime service in European relief and he was a master of it. The pressures of the depression pushed him to even greater energy in his efforts to expand private resources, but it was clear by 1931 that limits had been reached.

The system was effective in giving direction to an expanding economy. Private resources could provide the nation with ideas, but they lacked the muscle the emergency now required.

The New Deal did not replace the method; it expanded its use. Federal programs in housing, public works, and social welfare built on the private programs Hoover had helped to develop.

Many new Federal offices simply took over the staffs and programs of the private agencies, while foundations continued to provide support in the form of ideas and even subsidized salaries for advisory personnel. The line between public and private at the Federal level—a line that in State and local government had always been a meandering one—became blurred.

When Franklin Roosevelt wanted a study to enable him to reorganize the presidency, a private foundation provided the funding. When Congress wanted a study to enable it to oppose his reorganization, a private foundation provided the funding. As it happens, by the way, it was the same foundation.

The original foundations and many of those formed in the 1920's established characteristic administrative forms for themselves. Although today only some 1,500 of the more than 20,000 foundations identify themselves as having staffs, that method of organizing and carrying out programs was the most important contribution the early foundations made to the principle of the general purpose foundation.

Indeed, the creation of the professional philanthropist and the beginning of a profession of organized managers of philanthropic programs was essential to the development of modern philanthropy as a field built on ideas and purposes rather than on responses to random requests for money. That in itself did as much as anything to effect the transformation from charity to philanthropy.

Throughout the 1930's the number of new foundations increased as the frameworks for what were to become the new major foundations were laid in response to changes in tax laws. The Lilly Endowment and the Ford Foundation were both products of that period, although they were not destined to take their modern forms as major donors until after World War II.

As the number increased, so did the criticism from those who now saw them as devices for tax avoidance—which some of them indeed were—but also from those who echoed the criticisms made of the earlier foundations: that they were elite groups bent on influencing public policy and using public money to do it, that is, money that should have been taxed for public purposes.

One of the reasons Wright Patman is so interesting to me as a spokesman is that he became the most articulate spokesman for the latter points of view, lumping together the foundations created to avoid taxes without providing much, if any, public services, and those whose services he and others now considered dangerous influences.

The investigations of the decades between 1935 and 1955 all emphasized the rather fortuitous relation between the two criticisms, so that the older foundations found themselves caught between critics who considered them undemocratic manipulators of public policy in the interest of a small cadre of moneyed elites and critics who considered them the tools of radicals bent on revolution.

While the range of criticism tended to force the older foundations to rethink the programs they were willing to support and to seek ideas that were relatively safe from attack, it also led to the organization of groups like the Council on Foundations, and the Foundation Center and its library, whose purposes were directed toward assembling more information that could be made public, but also toward providing information within the growing foundation community itself.

Such groups attempted to bring more experienced foundation policies to the attention of newer organizations. A national foundation community was being created, and the profession of foundation managers expanded even further.

Between 1955 and 1965 another series of revolutionary changes began to take effect as the Federal Government moved into the funding of an even broader range of programs once the province of foundations. In every field, from science and medical research to public television and finally the arts, the creation of Government foundations and endowments dwarfed the resources of private foundations.

Some in the foundation field felt that their aims had been achieved and their utility ended and began to wonder, at times rather sadly, whether there was anything useful they could do that the Federal Government couldn't do better, or at least more lavishly.

Yet, again, the older foundations, to which the giant Ford Foundation had now been added, continued to play the role they had played since their beginnings. Expanded interests in international affairs in the years after World War II gave foundations an important function in advising the Department of State, and even in supplying it with a significant number of its top executives in both Democratic and Republican administrations.

The interaction between foundations and the Federal Government remained intensive as Government agencies gave money to foundations to support work more efficiently and less visibly than the agencies themselves. The habits established in the years since the First World War had been extended but they had not essentially changed. Yet public awareness seemed to grow more troubled.

Foundations, for example, had been funding education and medical care for black Americans since the turn of the century. When they extended that interest to voter registration, they tripped the wires that led ultimately to the investigation that eventuated in the Tax Act of 1969.

Foundations had been aiding the research and travel interests of policymakers temporarily out of jobs or in the process of relocating themselves, again, since the early years. But when news appeared that a foundation had engaged in such activities, it raised new questions.

Foundation research programs had investigated methods of birth control, food supply, the relationship between genetics and race, and the problems of underdeveloped societies again for years, but their activities now were being subjected to questioning.

Foundations had often supported research used to provide arguments in favor of legislation designed to improve living and working conditions, to protect the poor, the young, and the aged, to improve medical services and education. Yet now that these were also perceived as Government programs, foundations were now in danger of being perceived as policy lobbyists and penalized.

The whole relationship between universities, foundations, national policymaking and the selection of the Nation's leaders involved a series of new questions which suddenly appeared unattractive to critics and embarrassing to supporters of foundations.

Actually, nothing new was happening. The problem was that foundations were much more visible. The line between public and private was causing problems it had never caused before, partly because it was changed.

As government agencies began to provide research support once the province of foundations alone, it became increasingly difficult to distinguish the two efforts from one another.

More important, perhaps, foundations had always been the major support of programs that did not reflect a national consensus on what the public should support. Indeed, one could argue that they had come into existence precisely for that purpose.

Their critics had always come from those who believed that they should either confine themselves to programs about which there was acknowledged public interest or that it was their responsibility to expand public interest by their experimental investments. It had always been a difficult line to follow, and now it was becoming more difficult as, in their attempt to sustain their activities, they ran into a growing public demand for information.

What I have described thus far, I have tried to define for you in as neutral a tone as possible. I have confined myself to historical questions deliberately to distinguish a historical account from a judgmental account by a citizen who also happens to be a historian.

I would like to shift to that role because I think it is important to use historical judgment on this occasion to ask the question I know is most frequently asked: Are foundations a useful aspect of American history, even given their defects?

The answer, I believe, is yes, and I want to explain why.

Ever since the days of Tocqueville more than a century and a half ago now, commentators on American society have remarked on the fact that we are a very political people and we demand a political government that responds to our expressed needs.

We do not accept management by elites, even when we acknowledge the importance of experts, specialists, professionals, scientists, perhaps even historians. The people we ultimately selected to lead us can succeed only if they can convince us that they share our sense of that need for political responsiveness, immediate gratification, if you will. That is essential to our conception of democracy.

It is a remarkable system. But, as Tocqueville also pointed out, it has certain dangers inherent in it, chiefly an unwillingness to sustain over long periods of time those interests that might have to be sustained because our futures and the futures of countless generations may depend on them.

Foundations have come to play an essential role in the sustaining of long-range concerns with fundamental issues, not on the solutions to immediate problems. That was their function to begin with, and when it has worked at its best, it has served useful purposes.

The creation in recent years of a philanthropic profession has helped expand that function by giving the Nation a community of people who are able to focus attention on a wide range of issues, to experiment with programs that appear to have a chance not only of working but of serving as models for others, and to examine what they do critically.

That kind of self-examination has been central to the development of professional philanthropy as foundation staffs and boards of trustees review programs in ways that governmental bureaucracies have always found it extremely hard to do and as governmental inquiries force them to examine what they have done.

The professionalization of philanthropy in the foundation world is a slow and uneven process, however. The vast majority of foundations are still governed by family members and former business associates of the donor—in many instances now, second and third generations removed from the donors—with little experience in the process of philanthropy.

The tendency to insist that what they do is private and not subject to public inquiry will remain a source of some dispute, undoubtedly, and it should. Encouraging them to understand that they are engaged in a process of investment in matters in which the public has and must have an interest will remain an important endeavor.

The creation of regional organizations like the Minnesota Council on Foundations, the New York Regional Association of Grantmakers, the Donors Forum of Chicago, and the Southern California Association for Philanthropy have all marked the establishment of public forums for discussion designed to bring locally interested individuals together with more experienced grantmaking colleagues and potential donees to examine their common points of view. Other groups like Independent Sector and the Committee for a Responsive Philanthropy provide similar opportunities for openness and criticism.

In corporate philanthropy the increasing engagement of those responsible for corporate giving in such groups and the growing inclusion of people experienced in foundation philanthropy in the corporate world of philanthropy also point to the emergence of a profession. The Council on Foundations has begun to run training sessions to help newcomers understand the common problems they face, as well as the common responsibilities.

Much more needs to be done to improve the quality of foundation management, to open it to groups with a wide range of experience in the nonprofit world, and to help establish the standards that make a profession of public service clear.

For philanthropy is a service to the public. It has for years now served as a point of entry into many walks of public life and it has been extraordinarily useful in providing a special service orientation to our local and national leadership.

At the same time, the professional philanthropist reflects a problem Americans have always felt they had to control, an elitism that is, according to the language used most often to describe foundation managers, "arrogant." After all, money is power and power, as Lord Acton's adage put it, corrupts. Yet a complex modern society needs the kind of trained intellectual leadership modern philanthropy has helped to provide.

A society like ours needs to be able to control them, not because they are inherently dangerous, but because, like all sources of power and energy, they may be useful and necessary. One has only to look at a list of the Nation's administrative leaders in universities and Government over the last 80 years to see the role foundations and philanthropy have played in supplying knowledgeable personnel.

At the same time, as a historian of the period, I would have to remind you that times have changed, and with them some of our own needs with regard to traditional institutions. Government is now involved with policymaking in areas that were once entirely under private management in the early years of this century. That means that the separations between what is political and what is not are no longer as clear as they once were.

Private philanthropy is much more of a source of alternative programs for doing things Government agencies might wish to do differently, or which the public might wish Government not to do at all—the distinction between what services can be provided privately and what by the public is no longer as easy to make as it was 80 years ago, partly because the public's understanding of its own needs has changed.

Where education is concerned, the age of the self-taught, like the concept of the self-made, has been replaced by a new understanding of the minimal skills required for making a living, let alone for achieving great successes. Where medical services are concerned, we are a highly sophisticated society that can prolong life in unprecendented fashion and at unprecendented expense.

The much admired volunteers of yesteryear were often women of middle class means willing to be excluded from the workforce and able to learn jobs their professional counterparts now do, or women who accepted lower wages for essential community services like teaching and nursing. That age cannot be called back into being, even if we could agree that it ought to be called back.

Nor, in my opinion, should we consider the distinction between Government and private services the kind of exclusive distinction that calls on one to take over the other. Their partnership, even when it has come under critical attack, has been a fruitful one.

Our political society requires critical alternatives from outside, just as our private endeavors for the public good need the public scrutiny politics can provide. We could be another kind of people but we are not.

The foundation is an American invention. Like baseball, hamburgers and Kentucky Fried Chicken, it has been exported elsewhere, but no one has succeeded in giving it quite the flavor it has had here, partly because it was invented to serve our special needs. This does not mean it cannot be changed. It does mean that those needs have to be understood first.

Thank you for your attention.

Chairman RANGEL. Thank you, Professor.

[The prepared statement follows:]

STATEMENT OF BARRY D. KARL, NORMAN AND EDNA FREEHLING PROFESSOR OF HISTORY, THE UNIVERSITY OF CHICAGO

The American philanthropic foundation has been a subject of periodic controversy ever since the creation of the first foundations in the first decade of the 20th century. John D. Rockefeller originally requested a congressional charter for his foundation and Congress, after a lengthy debate, rejected the idea. By 1915 a commission appointed by President Wilson to investigate industrial unrest raised critical questions about foundation activities, and in the decades that followed foundations have come under scrutiny at ten to fifteen year intervals, the degree of acrimony varying from instance to instance, but the basic issues remaining pretty much the same. It might be useful to spell them out, since there are probably few instances that parallel the rather remarkable discrepancy between the purpose announced by the initial foundations—their devotion to the welfare of mankind—and the problems so often perceived in their activities.

Foundations came into existence at a point in world history when all industrialized societies were beginning to question the ability of traditional governmental forms to deal with the social and economic effects of industrialization. At the same time scientific discoveries were already making it clear that our abilities to preserve life and to destroy it were on a collision course and proceeding at breakneck speed. This was at the turn of the century, well before the dawn of the atomic age, but at a point where discoveries in medicine suggested revolutionary cures for all human diseases, while inventions in locomotion and explosives promised war-making capabilities on an escalating scale. Figures as far apart on an ideological spectrum as Pope Leo the Thirteenth and Karl Marx were calling on industrial societies to recognize the perils they faced and to reshape their conceptions of governmental responsibility for dealing with them.

For Americans such discussions took place within the context of a long history that rejected centralized national programs for copying with national problems. The limited role of the federal government was viewed as a protection of state and local responsibilities for the welfare of citizens. President Franklin Pierce had vetoed a bill in 1854 that would have created a national program for dealing with the mentally ill. The language he used became the catch phrase of all such defenses: that a federal program would "dry up the well-springs" of local charity. Subsequent efforts to introduce federal involvement in the education of the young faced similar rejection over the next century, while other societies, recognizing the need to educate succeeding generations as one of the fundamentals of human survival, developed various national programs.

In an important sense, the first modern foundations were an effort to establish national programs that would face such issues, not by providing direct support to local communities as charity, but by giving communities encouragement to help themselves with partial gifts to entice local contributions and, equally important, by providing them with carefully worked out programs based on the latest scientific knowledge and research to use as models for their own development. The specific rejection of charity as a method was part of that generation's revolution. They wanted to find root causes of poverty, to end palliative measures they believed only perpetuated the evils they wanted to wipe out. By the 1920's foundations had adapted for themselves a model of behavior that can be described quite easily. By organizing and developing new methods of coping with social problems, they could provide experimental resources that would enable communities to see what might be useful to them and then to adopt them for themselves. The idea was that local governments would not have to bear the cost of experiments but would then be able to select and pay for the workable services themselves, while foundations would move on to other experiments.

One of the earliest such ideas was the Carnegie library, which involved the gift of the building, but required the community to provide the books and the management. Similar arrangements gave the new family and juvenile courts the opportunity to see if social workers in the courtroom would help families deal with the law. Chicago philanthropy provided a period of school counseling in the public schools, once compulsory education kept increasing numbers of unwilling pupils in classrooms. School lunches were provided under another such experiment. A Guggenheim family foundation even offered to help paint direction signs on rooftops and in open fields to aid early airplanes in finding their way from one city to another.

The principle was always the same. Foundations were there to help find the way; but public responsibility, either in the form of matching funds from other philanthropists or in the assumption by local government of financial responsibility, was to be the ultimate end. This was a realistic appraisal, too, of the limits of foundation resources and a judgement of the best uses to which such funding could be put.

The method reached its zenith, perhaps, in the 1920's and 30's. Herbert Hoover became its champion, using foundation funding to provide economic research ideas for the nation's business during his years as Secretary of Commerce, and then working to organize foundation support for programs during his presidency. He had had experience with the idea which went back to his wartime service in European relief and he was a master of it. The pressures of the Depression pushed him to even greater energy in his efforts to expand private resources, but it was clear by 1931 that limits had been reached. The system was effective in giving direction to an expanding economy. Private resources could provide the nation with ideas, but they lacked the muscle the emergency now required.

The New Deal did not replace the method, it expanded its use. Federal programs in housing, public works, and social welfare built on the private programs Hoover had helped develop. Many new federal offices simply took over the staffs and programs of the private agencies, while foundations continued to provide support in the form of ideas and salaries for advisory personnel. The line between public and private at the federal level—a line that in state and local government had always been a meandering one—became blurred. When Roosevelt wanted a study to enable him to reorganize the presidency, a private foundation provided the funding. When Congress wanted a study to enable it to oppose his reorganization, a private foundation provided the funding. As it happens, by the way, it was the same foundation.

The original foundations and many of those formed in the 1920's established characteristic administrative forms for themselves. Although today only some 1,500 of the more than 20,000 foundations identify themselves as having staffs, that method of organizing and carrying out programs was the most important contribution the early foundations made to the principle of the general purpose foundation. Indeed, the creation of the professional philanthropist and the beginning of a profession of organized managers of philanthropic programs was essential to the development of modern philanthropy as a field built on ideas and purposes rather than on responses to random requests for money. That in itself did as much as anything to effect the transformation from charity to philanthropy.

Throughout the 1930's the number of new foundations increased as the frameworks for what were to become the new major foundations were laid in response to changes in tax laws. The Lilly Endowment and the Ford Foundation were both products of that period, although they were not destined to take their modern forms as major donors until after World War II. As the number increased, so did the criticism from those who now saw them as devices for tax avoidance—which some of them indeed were—but also from those who echoed the criticisms made of the earlier foundations: that they were elite groups bent on influencing public policy and using public money to do it, that is, money that should have been taxed for public purposes. Wright Patman became the most articulate spokesman for the latter points of view, lumping together the foundations created to avoid taxes without providing much, if any, public services, and those whose services he and others now considered dangerous influences. The investigations of the decades between 1935 and 1955 all emphasized the rather fortuitous relation between the two criticisms, so that the older foundations found themselves caught between critics who considered them undemocratic manipulators of public policy in the interest of a small cadre of moneyed elites and critics who considered them the tools of radicals bent on revolution.

While the range of criticism tended to force older foundations to rethink the programs they were willing to support and to seek ideas that were relatively safe from attack, it also led to the organization of groups like the Council on Foundations, and the Foundation Center and its library, whose purposes were directed toward assembling more information that could be made public, but also toward providing information within the growing foundation community itself. Such groups attempted to bring more experienced foundation policies to the attention of new organizations. A national foundation community was being created, and the profession of foundation managers expanded even further.

Between 1955 and 1965 another series of revolutionary changes began to take effect as the federal government moved into the funding of an even broader range of programs once the province of foundations. In every field, from science and medical research to public television and finally the arts, the creation of government foundations and endowments dwarfed the resources of private foundations. Some in the foundation field felt that their aims had been achieved and their utility ended and began to wonder, at times rather sadly, whether there was anything useful they could do that the federal government couldn't do better, or at least more lavishly. Yet, again the older foundations, to which the giant Ford Foundation had now been added continued to play the role they had played since their beginnings. Expanded interests in international affairs in the years after World War II gave foundations an important function in advising the Department of State, and even in supplying it with a significant number of its top executives in both Democratic and Republican administrations. The interaction between foundations and the federal government remained intensive as government agencies gave money to foundations to support work more efficiently and less visibly than the agencies themselves. The habits established in the years since the First World War had been extended but they had not essentially changed. Yet public awareness seemed to grow more troubled.

Foundations, for example, had been funding education and medical care for Black Americans since the turn of the century. When they extended that interest to voter registration they tripped the wires that led ultimately to the investigation that eventuated in the Tax Act of 1969. Foundations had been aiding the research and travel interests of policymakers temporarily out of jobs or in the process of relocating themselves, again, since the early years; but when news appeared that a foundation had engaged in such activities, it raised new questions. Foundation research programs had investigated methods of birth control, food supply, the relation between genetics and race, and the problems of underdeveloped societies for years, but their activities now were being subjected to questioning. Foundations had often supported research used to provide arguments in favor of legislation designed to improve living and working conditions, to protect the poor, the young, and the aged, to improve medical services and education. Yet, foundations were now in danger of being perceived as policy lobbyists and penalized. The whole relationship between universities, foundations, national policymaking and the selection of the nation's leaders involved a series of new questions which suddenly appeared unattractive to critics and embarrassing to supporters of foundations.

Actually, nothing new was happening. The problem was that foundations were now much more visible. The line between public and private was causing problems it had never caused before partly because it was changing. As government agencies began to provide research support one the province of foundations alone, it became increasingly difficult to distinguish the two efforts from one another. More important, perhaps, foundations had always been the major support of programs that did not reflect a national consensus on what the public should support. Indeed, one could argue that they had come into existence precisely for that purpose. Their critics had always come from those who believed that they should either confine themselves to programs about which there was acknowledged public interest or that it was their responsibility to expand public interest by their experimental investments. It had always been a difficult line to follow, and now it was becoming more difficult as, in their attempt to sustain their activities, they ran into a growing public demand for information.

What I have described thus far, I have tried to define for you in as neutral a tone as possible. I have confined myself to historical questions deliberately to distinguish a historical account from a judgemental comment by a citizen who also happens to be a historian. I would like to shift to that role because I think it is important to use historical judgement on this occasion to ask the question I know is most frequently asked. Are foundations a useful aspect of American history, even given their defects? The answer, I believe, is yes, and I want to explain why.

Ever since the days of Tocqueville more than a century and a half ago now, commentators on American society have remarked on the fact that we are a very political people and we demand a political government that responds to our expressed needs. We do not accept management by elites, even when we acknowledge the importance of experts, specialists, professionals, scientists, perhaps, even, historians. The people we ultimately select to lead us can succeed only if they convince us that they share our sense of that need for political responsiveness, immediate gratification, if you will. That is essential to our conception of democracy. We punish infractions severely. We have had difficulty accepting attempts to control what we eat and drink, what we smoke, how we drive, the way we treat one another. Other societies never really understand that aspect of our response to law and our view of political individuality; and while it has made us difficult to understand, it has also made us one of the most flexible societies in history, capable of changing attitudes, creating new programs, destroying old ones, and defying traditions simply by forgetting what they were.

It's a remarkable system; but, as Tocqueville also pointed out, it has certain dangers inherent in it, chiefly an unwillingness to sustain over long periods of time those interests that might have to be sustained because our futures and the futures of countless generations may depend on them. Our politics may look merciless to outsiders and our laws incredibly flexible. But nature is even more merciless, and its laws unbreakable, and we live in nature. The era of the creation of foundations was an era of great consciousness of that increasing inflexibility, but also of a need to explore on a long-range basis the sciences of nature and human life that could be manipulated by us, even if they could not entirely be controlled. That exploration is not a political process, though as a people we are capable of politicizing anything. One can ask, what has that to do with charity, after all, and the answer is one the originators of the foundation idea would have given you very clearly. They had become disillusioned with charity, and were seeking a new vision of human welfare. That may have been a utopian vision, but it was based on their many years of involvement with the nation's charities, and on their belief that short-range solutions were not only unworkable but wasteful. They were equally suspicious of political solutions to problems. They wanted to create a generation of philanthropic managers whose independence from politics would assure them that the solutions they arrived at were based on what they considered objective knowledge, not on partisan political judgements or public pressures.

Foundations have come to play an essential role in the sustaining of long-range concerns with fundamental issues, not on the solutions to immediate problems. That was their function to begin with, and when it has worked at its best, it has served useful purposes. The creation in recent years of a philanthropic professsion has helped expand that function by giving the nation a community of people who are able to focus attention on a wide range of issues, to experiment with programs that appear to have a chance not only of working but of serving as models for others, and to examine what they do critically. That kind of self-examination has been central to the development of professional philanthropy as foundation staffs and boards of trustees review programs in ways that governmental bureacracies have always found it extremely hard to do and as governmental inquiries force them to examine what they have done.

The professionalization of philanthropy in the foundation world is a slow and uneven process, however. The vast majority of foundations are still governed by family members and former business associates of the donor—in many instances, now, second and third generations removed from the donors—with little experience in the process of philanthropy. The tendency to insist that what they do is private and not subject to public inquiry will remain a source of some dispute, undoubtedly, and it should. Encouraging them to understand that they are engaged in a process of investment in matters in which the public has and must have an interest will remain an important endeavor.

The creation of regional organizations like the Minnesota Council on Foundations, the New York Regional Association of Grantmakers, the Donors Forum of Chicago, and the Southern California Association for Philanthropy have all marked the establishment of public forums for discussion designed to bring locally interested individuals together with more experienced grantmaking colleagues and potential donees to examine their common points of view. Other groups like Independent Sector and the Committee for a Responsible Philanthropy provide similar opportunities for openness and criticism.

In corporate philanthropy the increasing engagement of those responsible for corporate giving in such groups and the growing inclusion of people experienced in foundation philanthropy in the corporate world of philanthropy also point to the emergence of a profession. The Council on Foundations has begun to run training sessions to help newcomers understand the common problems they face, as well as the common responsibilities. Much more needs to be done to improve the quality of foundation management, to open it to groups with a wide range of experience in the non-profit world, and to help establish the standards that make a profession of public service clear. For philanthropy is a service to the public. It has for years now served as a point of entry into many walks of public life and it has been extraordinarily useful in providing a special service orientation to our local and national leadership.

At the same time, the professional philanthropist reflects a problem Americans have always felt they had to control, an elitism that is, according to the language used most often to describe foundation managers, "arrogant". After all, money is power and power, as Lord Acton's adage put it, corrupts. Yet a complex modern society needs the kind of trained intellectual leadership modern philanthropy has helped provide. A society like ours needs to be able to control them, not because they are inherently dangerous, but because, like all sources of power and energy, they are useful and necessary. One has only to look at a list of the nation's administrative leaders in universities and government over the last eighty years to see the role foundations and philanthropy have played in supplying knowledgeable personnel.

At the same time, as a historian of the period I would have to remind you that times have changed, and with them some of our own needs with regard to traditional institutions. Government is now involved with policy-making in areas that were entirely under private management in the early years of this century. That means that the separations between what is political and what is not are no longer as clear as they once were. Private philanthropy is much more of a source of alternative programs for doing things government agencies might wish to do differently, or which the public might wish government not to do at all. The distinction between what services can be provided privately and what by the public is no longer as easy to make as it was eighty years ago, partly because the public's understanding of its own needs has changed. Where education is concerned, the age of the self-taught, like the concept of the self-made, has been replaced by a new understanding of the minimal skills required for making a living, let alone for achieving great successes. Where medical services are concerned, we are a highly sophisticated society that can prolong life in unprecedented fashion and at unprecedented expense. The much admired volunteers of yesteryear were often women of middle class means willing to be excluded from the workforce and able to learn jobs their professional counterparts now do, or women who accepted lower wages for essential community services like teaching and nursing. That age cannot be called back into being, even if we could agree that it ought to be called back.

Nor, in my opinion, should we consider the distinction between government and private services the kind of exclusive distinction that calls on one to take over the other. Their partnership, even when it has come under critical attack, has been a fruitful one. Our political society requires critical alternatives from outside, just as our private endeavors for the public good need the public scrutiny politics can provide. We could be another kind of people but we are not. The foundation is an American invention. Like baseball, hamburgers and Kentucky fried chicken it has been exported elsewhere, but no one has succeeded in giving it quite the flavor it has had here, partly because it was invented to serve our special needs. This does not mean it cannot be changed. It does mean that those needs have to be understood first.

Chairman RANGEL. In reviewing your testimony on page 7, concerning the climate surrounding the Tax Act of 1969, do you believe, as a historian, that voter registration is a proper function of foundations?

Mr. KARL. Yes, I do. I believe that aid to people in that kind of need was an important thing for foundations to be doing.

Chairman RANGEL. You go on further and mention that foundations had often supported research used subsequently to provide arguments for legislation designed to improve living and working conditions, to protect the poor, the young, the aged, to improve medical service and education.

Do you believe that foundations today are still providing that function or are they impeded by the 1969 act Have they responded to changes in society?

Mr. KARL. My judgment from what I have seen in the years since 1969 has been that foundations have tended to step back from critical areas which they felt might subject them to attack. Some have tried to avoid conflict with political groups who may oppose positions they were interested in supporting.

There was, I believe, a regulation proposed in January 1981 that would have removed tax exemption from any foundation whose activities ended up in legislation within 2 years. Nothing came of it, but it suggests a mood of criticism that is, historically at least, disturbing.

Chairman RANGEL. Do you believe that today, with the exception of lobbying and legislation, that foundations are tending to support safe and established enterprises rather than to promote the concepts which you recently discussed?

Mr. KARL. Well, you are talking about a wide range of foundations, a wide range of organizations.

Chairman RANGEL. You see, as you and Chairman Mills pointed out, we are legislating within an atmosphere of perceptions. You are the historian, and of course there will be exceptions to every rule. And we assume that where there was abuse, it was only a handful.

Now, in terms of perception, do you believe the courageous work that has been done by foundations in the past—leaving out lobbying and legislation because of projected proposed legislation—that they still are involved in that type of work or do they tend not to take risks and merely support very safe and conservative type projects?

Mr. KARL. Well, the language that you are using is a little deceptive.

I think you would find a range now in the foundation world of what I suppose one would call very conservative interests on the part of some foundations, very liberal, even radical, relatively speaking, interests on the part of others. I think that what you need to look at really is a broad range of options.

I think that foundations at their best have tended to explore available opportunities, and foundations, I believe, by and large, are continuing to do that today.

I think what you are going to have to keep in mind is the historical point, simply, that one generation's conservative idea may become the next generation's liberal ideal and vice versa. That is, we deal with these experiments, with these investigations over time. One could cull from the past a whole variety of issues that were once totally rejected issues.

I mentioned birth control here, which would have been kept alive only I think by private philanthropy. Support of education in the south existed through most of the period after the Civil War primarily win the support of private philanthropy and private organizations. There is a range of things understood or perceived differently.

Chairman RANGEL. Are you satisfied that enough is paid out to the public benefit by private foundations or should there be legislation requiring more payout for public benefit?

Mr. KARL. That is a hard question for a historian to answer.

I think my own answer to that would be a willingness on my part—in fact, an enthusiasm on my part—for allowing foundations to make their judgments. It seems to me that what you have in the foundation world at its best is the exercise of that kind of philanthropic experience and judgment.

I think when you place restrictions on that you place restrictions that may force foundations to engage in behavior that may not be based on their own best judgments.

Chairman RANGEL. You have no problem with making foundations accessible to public inquiries?

Mr. KARL. I am as enthusiastic about that, although I have been both impressed and disappointed. I am impressed with the fact that many, many more foundations are now issuing reports that accurately reflect what they do; I am disappointed that there are still people in the foundation world who will insist they are engaged in a private activity. They—they believe—are not accountable to the public. There is still room for more openness.

I am much in favor of anything which speeds the availability of information to the public.

Chairman RANGEL. Do you have any particular tax writing recommendations to make to the committee?

Mr. KARL. No, I don't.

Chairman RANGEL. Do any foundations support your efforts with Stanley Katz in working on this comprehensive history?

Mr. KARL. They certainly do, as has the National Endowment for the Humanities. We have tried to get support from all interested sources.

In response to that, I would say, too, we have been allowed access to information, archival information at foundations that was previously not available to historians for research.

Chairman RANGEL. Is it one foundation supporting your work or most of them?

Mr. KARL. No, we have had a small but significant group.

It started with the Ford Foundation, and it has included the Rockefeller Foundation. The Commonwealth Fund has been helpful to us. Exxon, has been supportive as well as the Sloan Foundation and the Lilly Endowment. Since we are now in the process of finishing the first volume and starting on the second, we have an application in to the National Endowment for the Humanities.

Chairman **Rangel**. How many volumes do you intend to write?

Mr. **Karl**. Two. The dividing line we have selected for ourselves is 1935, because it is the year of Social Security Act of 1935 and the development of housing legislation in 1936, 1937, so on, that indicate for us a significant change in the relation between foundations and government. That period of time witnessed the creation of the partnership I was attempting to describe.

Chairman **Rangel**. Thank you very much. It is unique for this committee to have a historian from the university system and also a historian from the legislative perspective. We are indeed fortunate this morning.

Mr. Duncan.

Mr. **Duncan**. Thank you, Mr. Chairman.

Should voter registration—you indicate that you highly favor it—be targeted towards certain areas or to groups with special interests?

I wish you could elaborate a little further on the voter registration which in the past has caused some public criticism of using tax-free dollars for that purpose.

Mr. **Karl**. I think the principle behind the aid to voter registration was the fact that the communities themselves were not encouraging voter registration and were indeed impeding voter registration. As in the case of Negro education after the crisis was when philanthropists moved into the South to provide medical care and education, they were doing something that local communities were unable or unwilling to do for themselves.

One could argue they should have criticized the practice of segregation and indeed they have been attacked for that by historians who believe that John D. Rockefeller and Julius Rosenthald impeded education in the South by providing a minimally suitable alternative. The historical battle is there.

I think that you would also find imaginative philanthropy still working at the edge of community agreement. There has been no alternative, I think, to that, and we can be grateful for those who have been willing to get themselves into difficulty for doing it.

People do not agree on what is "creative" or "innovative." They are terms that can mask a great deal of hostility.

Mr. **Duncan**. With the new voter rights legislation we have in the country today, do you think there is a necessity to have the foundations free to go in anywhere they might desire without any test to contest the local or State elections? Do you think that is a proper role of foundations?

Mr. **Karl**. I think if you believe that Federal legislation still does not protect voter registration, as it did not in the past, then I think it would be a question of judgment by the foundations as to whether they actually——

Mr. **Duncan**. Do you believe that?

Mr. **Karl**. Do I believe that?

Mr. **Duncan**. Yes, sir.

Mr. **Karl**. I am not so much a truster of the effectiveness of law in all of its instances in our history to be willing to say that there are not moments when it is necessary for private critics to walk in and say you are not doing it the right way.

Mr. **Duncan**. Are you the truster of a person who is the head of a foundation to select an area to go in and perhaps try to control the election or——

Mr. **Karl**. Not without a fight. I think the fight is what I am looking for, what I am concerned with is that laws not stop the confrontations that from time to time simply have to take place as a society becomes more experienced, more educated, more compassionate about what it is doing. I think foundations when they have worked at their best have pushed for those fights and gotten them.

Mr. **Duncan**. Thank you very much.

Chairman **Rangel**. Mr. Thomas.

Mr. **Thomas**. Thank you, Mr. Chairman.

Dr. Karl, in your judgment did Congress over-react in 1969?

Mr. **Karl**. Yes.

Mr. **Thomas**. In your judgment has there been any permanent damage to the practicing of foundations because of the 1969 act? Or can we make adjustments which would allow the creativity that was present in an earlier period to continue?

Mr. **Karl**. I don't think there is any question but that you can make judgments that would allow that kind of creativity.

Mr. **Thomas**. What was the good in your judgment that came from the 1969 act?

Mr. **Karl**. Forgive me for repeating myself, the good judgment was the fight, the fact that foundations were pushed into an open and a public position within the foundation world itself. I think the greatest good all of these investigations have done, if you will forgive me, and they may not, is that it has forced them to work with one another and to pay attention to helping one another. The foundations have tended to operate in a very anarchistic form traditionally and that is to say, they have been concerned with their own interests and their own programs.

I think this consciousness of a community created by critical investigations is probably one of the most important things that has happened in the foundation world.

Mr. **Thomas**. Do you think this panel would be well served if we investigated whatever specific operations foundations might be involved in? Should we look more basically at the generic activities of foundations?

Mr. **Karl**. I think that the engagement in specific investigation is fruitless. I do not think that that is useful to foundations. A program-by-program critique would be stifling and destructive.

I think the generic approach, the examination of the foundation operation as a whole is about the only way you can go at what what seems to be a rationally and historically justifiable enterprise.

Mr. **Thomas**. As we examine the foundation area, you indicated that one of the beneficial functions of the 1969 act was the need to band together to understand how each other were responding to the various requirements in large part from the tax end of it. I have had a number of foundations visit me and attempt to explain the position that they are in on the basis of the tax policy provisions of the 1969 act.

Do you believe in your judgment on the historical basis that this panel would be well served by attempting to expand the, what I would term, fairly procrustean provisions of very general tax provisions which may or may not benefit the particular foundation but which have a kind of an absolute all-encompassing requirement for all foundations?

I guess that is a pretty loaded question the way I put it.

Mr. KARL. If I could rewrite the history I would say that one of the basic problems in foundation history in the United States is the fact that taxation has had to be the method of regulating. If there were another way of regulating that I could think of I would hunt for it.

But it is the way we have decided to do it and it is the method. I think to use the method inflexibly, rigidly, particularly given the range of interests of a foundation and its utility, is always a mistake. There is no other method historically that I could see that we could devise for ourselves. It is a decision that was made at the turn of the century and we are stuck with it.

Mr. THOMAS. What about an open-ended or close-ended tax procedure? That is should there be a definite life period for a particular foundation?

Mr. KARL. It is funny, that is probably one of the oldest and most fascinating issues. As you may know there were creators of foundations who felt foundations should only exist for a period of years. Julius Rosenwald deliberately put a death sentence on his own. Louis Brandeis believed foundations should not exist in perpetuity. John D. Rockefeller, Junior and Senior, got into battle about it when Senior wanted to end it and give the money away and Junior said no, he wanted it to exist in perpetuity.

It is probably one of the basic questions that one can ask. My answer to it, again, speaking historically, is that certainly over the last 50 years American society has created within itself a useful dependence on the foundation and the foundation world. I think if you were to remove it you would have to find a replacement for it. If it were not there it would have to be created, not only because of the institution of the foundation, but because of the governmental institutions we have built for ourselves parallel to it.

Mr. THOMAS. Thank you very much.

Chairman RANGEL. Mr. Martin.

Mr. MARTIN. No questions, Mr. Chairman.

Chairman RANGEL. Let me thank both of you very much for your testimony today.

The Chair will call, from the Department of the Treasury, the Honorable John Chapoton, Assistant Secretary for Tax Policy.

Also I call James Owen, Acting Commissioner of the IRS, accompanied by S. Allen Winborne, Assistant Commissioner, Employee Plans and Exempt Organizations.

STATEMENT OF HON. JOHN E. CHAPOTON, ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY

Chairman RANGEL. Mr. Secretary, I would think you would agree we have had a good history of foundations. I know you are familiar with that history and it is included in your testimony. What we are concerned with is the 1969 Act, what has been the impact on the Treasury as well as on foundations and more importantly, what changes, if any, do you think the tax writing committee should be looking at.

Of course, as always you can proceed as you think will be most beneficial to the committee knowing that your full statement will appear in the record.

Mr. CHAPOTON. Thank you, Mr. Chairman.

I will—my comments in general go more to the questions that have been raised for suggested changes in the legislation in the 1969 act. I think Mr. Owen will discuss some data relating to foundation growth. I am not sure any of us have the data that we need; perhaps this subcommittee will develop that data here to see what the impact has been of the 1969 legislation.

We start out by saying, Mr. Chairman, I am happy to be here, of course, to review with you the current rules governing private foundations. Private foundations do provide for diversity and flexibility in philanthropic endeavors. Foundations by reflecting the concerns, interests and experience of their creators have increased the diversity of charitable works. In addition, because of the assets of private foundations are often not committed to specific operating programs, foundations are able to shift their financial support from one charitable area to another relatively easily. The pool of charitable funds that can be used to support new charitable ventures may encourage evolution and growth in the area of charitable activities which is of course a good factor.

The same factors that give foundations a unique role in philanthropic endeavors, that is, influence of a small number of people and the existence of uncommitted funds, also create the potential for use of foundations for private benefit. While foundations in general have been operated responsibly and for the public benefit, prior to 1969 there were serious abuses among a minority of foundations.

We recognize and I think the subcommittee must recognize that prevention of diversion of charitable funds for private purposes has not been accomplished without a cost. The private foundation rules in the 1969 act imposed administrative burdens on the organizations to which they apply. In evaluating those rules it is important to weigh the detriment to charity from abusive use of private foundations against the detriment to charity from imposition of restrictions on private foundations.

Some have claimed and I think you will hear in these hearings, Mr. Chairman, that the 1969 rules are so restrictive and burdensome that they have caused a reduction in the number of existing foundations and a decline in the amount of charitable giving to foundations. We have found as I mentioned at the outset, the available data on birth and death rates of foundations and on charitable giving both to foundations and to all charities to be inadequate to determine whether there have been such declines.

Our analysis of the rather limited information readily available indicates that giving to foundations increased as a percentage of total charitable giving from 1974 to 1979. I want to emphasize that we are concerned that the data that I have mentioned is defective and should not be used as a guide for policy. We simply don't have adequate data.

Chairman **Rangel**. Mr. Secretary, wouldn't you know how many groups have asked to become foundations? Has there been an increase in the applications?

Mr. **Chapoton**. Well, based on our information from tax returns, there has been an increase in the number of foundations. Also, there have been increases in gifts to foundations. The argument over the number of foundations is whether we are counting foundations; that are not what the foundation community views as foundations; that is, grant-making foundations. We are also counting operating foundations and the public charities kicked over into the foundation status. I think we ought to try to get a fix on that.

Chairman **Rangel**. I guess my question is, would you have any knowledge of how many grant-making foundations have requested to be recognized for tax exemption?

Mr. **Chapoton**. Well, we have, of course, the numbers on those that are requesting exemption. To get to the point of whether they are grant making, you have to analyze the specific characteristics of each of the foundations. We have not done that.

I think the historical perspective that the subcommittee has taken this morning is interesting. Just to give a bit of a background that I think is important from our standpoint, the government has, of course, encouraged private philanthropy since 1917 when the income tax deduction for charitable gifts was first allowed. There is a further benefit through the exemption from taxation of investment income earned by organizations that conduct these activities. These are substantial benefits.

Congress first addressed the problem of the use of charitable assets for noncharitable purposes in the Revenue Act of 1950. That act denied tax-exempt status and disallowed deductions for contributions to certain organizations that engage in so-called prohibited transactions but certain other organizations such as religious organizations, educational organizations and publicly- or governmentally-supported organizations were not subject to the rules; because of their public character they were not believed likely to become involved in prohibited transactions.

Unfortunately the 1950 legislation did not handle all the problems. A principal reason that it didn't work was the administrative difficulty created by the vagueness of the statutory standards in the 1950 law. A secondary problem with that statutory approach was that the penalty was loss of exemption and denial of deductions for contributions. This was so severe that it was rarely imposed and therefore did not act as a good administrative tool in dealing with the problems.

As Mr. Mills mentioned, the tax-writing committees requested the Treasury Department to conduct a study of the private foundations. This resulted in the 1965 Treasury Report which was a principal factor considered in developing the 1969 act.

That report did find that charitable assets were being used to a substantial extent for noncharitable purposes through self-dealing, through undue delay in delivery of benefits to charities and involvement in businesses resulting in use of noncharitable assets.

These conclusions were the basis in large part for the 1969 response to the problems in the foundation area.

My written statement goes in some detail into the 1969 act private foundation rules, the abuses they were directed toward, and the reasons specified for the particular form in which the rules were enacted.

I don't wish to cover that this morning. I do want to mention two of those provisions because they relate to two of the main provisions in which change has been sought. The first is the self-dealing provision and the other is the excess business holding restriction.

Congress first dealt with self-dealing in 1950, but did so in a manner intended to prevent foundations from engaging in transactions on terms unfair to the foundation if the transaction was with a donor or certain related persons. The IRS found it very difficult to apply the standard of fairness.

The 1965 Treasury Report concluded that even a transaction which is fair in the sense that the terms of the immediate transaction are reasonable may nevertheless benefit the donor and harm the foundation. For example, loans at a reasonable rate of interest to a disqualified person might nevertheless cause the foundation to keep funds available, in case the loan is needed, to the detriment of the foundation.

So in 1969, Congress decided to prohibit even arm's-length transactions between a private foundation and a donor or certain other parties. This prohibition is enforced by imposing the sanction of a penalty tax on the self-dealer and on the foundation manager who participates in a transaction knowing it to be an act of self-dealing. The related persons who are subject to the prohibition are known as disqualified persons.

The second significant area of abuse highlighted in the 1965 report of the Treasury, and with respect to which the Congress had not passed prior legislation, was ownership of active business enterprises by foundations.

Extensive private foundation ownership of business was found in the 1965 report to raise a number of problems. For example, the rate of return that a tax-exempt entity must demand from its investment in a business could be lower than the rate of retrurn that a taxable investor would demand. The 1965 report noted a common willingness of foundations to defer indefinitely realization of profits from investment in commercial enterprises. Such deferrals not only provided such a competitive advantage to the business but also resulted in deferral of benefits to charities.

Another problem described in the 1965 report was that foundation control of business enterprises provided such a broad spectrum of opportunities for the foundations' assets to be used for noncharitable purposes that it was virtually impossible to deal with all these problems legislatively. Finally, the 1965 report pointed out that substantial ownership of a business by a foundation could be detrimental to charity because the attention of the foundations' managers might be drawn away from charitable pursuits.

In recognition of these problems, in 1969 Congress prohibited foundations alone or in conjunction with disqualified persons from owning substantial portions of any active business enterprise. It gave substantial transition periods of up to 20 years to make initial dispositions of excess business holdings held in 1969.

Our analysis of these rules makes it clear that in at least two respects they were a vast improvement over prior law. First the imposition of a penalty tax on the persons responsible for improper activity is a great improvement over denial of a tax exemption as the penalty. There is more flexibility in that approach and it is much easier to administer

Second, the objective standards provided in the current rules establish clear guidelines for compliance by foundations and make administration by the service much easier than prior law. We recognize that the restrictions in the 1969 act may in some cases prevent a foundation from engaging in a transaction or making investments or making a grant that the foundation managers believe would best serve charitable purposes, but any evaluation of these rules must take into account the evidence presented in the 1965 Treasury Report on the potential detriment to charity in the absence of clear and administrable rules prohibiting the use of charitable assets for private purposes.

Now, if I might, Mr. Chairman, let me just discuss our reaction to a couple of suggestions for change in the private foundation rules.

First, relating to the charitable contribution limits on gifts to private foundations, there are, as Mr. Mills mentioned, several distinctions in the deductibility of contributions to private foundations and contributions to public charities. First, and foremost, there is a 20 percent of adjusted gross income limit on gifts to private foundations whereas the general rule on gifts to public charities is 50 percent.

Second, with respect to gifts of appreciated property, with few exceptions, the full fair market value is deductible with respect to a gift to a public charity, whereas the deduction for the gift of the same property to a foundation would be reduced by the gain that would be taxed to the donor if the property had been sold; that is 40 percent at the present time.

In addition, contributions to public charities in excess of the 50 percent limit may be carried over for 5 years but no carryover is permitted for contributions to private foundations in excess of the 20 percent limit.

Congress first distinguished between contributions to public charities and contributions to private foundations in the Internal Revenue Code of 1954 when the limitation on contributions to churches, schools, or hospitals was increased from 20 to 30 percent. The stated purpose of this change was to aid the specified institutions in obtaining additional funds they needed in view of the rising costs and relatively low rate of return they received on endowment funds.

In 1964 the benefit of the limit was extended to publicly supported or governmentally supported organizations. The committee report in 1964 stated the extra 10 percent was intended to encourage immediately spendable receipts for charitable organizations. The Senate Finance Committee report said the 10 percent was not allowed for contributions to private foundations stating that such organizations frequently do not make contributions to operating philanthropic organizations for extended periods of time and in the meanwhile use the funds for investment.

Thus there does exist a longstanding policy that contributions to certain essential service organizations and charitable organizations that can be expected to spend their funds promptly in the conduct of charity are to be preferentially encouraged. The foundation community has identified the 20-percent limit as a major factor inhibiting the growth of private foundations and has suggested that lifetime contributions to foundations should receive the same treatment as contributions to public charities.

We are not prepared to recommend a change in the basic policy that lifetime contributions to public charities should be preferentially encouraged without substantial evidence that private foundations are suffering adverse effects as a result of the limitations placed on the deductibility of contributions to them. As I mentioned earlier, we have not seen any reliable data to support the claim of the foundation community that the limitations on deductibility of lifetime giving are seriously reducing contributions to foundations. In fact there is some indication that contributions to charitable foundations as a percentage of total contributions are increasing.

In addition we would oppose the proposal that donors be allowed to deduct the full fair market value of appreciated property contributed. The income tax charitable deduction generally permits the donor to make a contribution with pretax dollars. If the donor is allowed to deduct the full value of appreciated property, he receives a substantially increased tax benefit beyond just allowing the gift to be made out of pretax dollars, since the deduction of the amount of appreciation reduces the taxable income from other sources. Also, the full deductibility of appreciation provides increased potential for abuse through the overvaluation of assets that are the subject of a gift.

Congress has chosen to provide this greater tax benefit only with respect to public charities and we believe it is appropriate to continue this limit in that manner. We would point out that we continue to have some concerns about the overvaluation of gifts that are the subject of charitable gifts even in the public charity context.

With respect to the 5-year carryover provision, we don't see any reason to limit the benefit to charity by requiring the donor to postpone the gift until he can use the 20-percent limit in later years and therefore we would support extension of the 5-year carryover rule to contributions to private foundations.

Turning to excess business holdings, this is perhaps the most criticized provision of the 1969 act. A number of foundations have suggested that the excess business holding requirements are unnecessary and detrimental to charity. They argue that the self-dealing and minimum distribution requirements in the 1969 act are sufficient to prevent abuses. In some cases, foundations say that disposition of their excess business holdings are detrimental to charity because the deadline for disposition increases the opportunity for buying a business at a lower price.

Other foundations state they wish to retain their excess business holdings because they cannot find a buyer who will continue to operate the business in the same manner and at the same location as it is operated by the foundation. Each of these argues that the business as they operate it provides special benefits to the community that justify continued ownership by the foundation.

We would oppose elimination of the restriction on excess business holdings. We don't consider the prohibition on self-dealing and the minimum distribution requirement of the 1969 act to be sufficient to prevent the problems presented by foundation ownership and control of business.

The possibilities of conferring private benefit through a controlled business are numerous and in many cases very subtle. It is not possible to draft or administer a statutory prohibition of all possible acts of self-dealing involving a foundation-controlled business.

The minimun distribution requirements may be ineffecive in preventing substantial delays in delivery of benefits where a foundation holds a substantial interest in a private business enterprise. The minimum distribution requirements depend on a valuation question which substantially undermines the effectiveness of that requirement in the context of a closely held business. Even if valuation is not a problem the minimum distribution requirement does not prevent deferral of benefits to charities. The foundation may receive a negligible return on one investment such as a controlled business and still be able to satisfy its minimum distribution requirement out of its income from other investments. Thus we don't consider the minimum distribution requirement sufficient to insure that benefits of investment of charitable funds are reserved for and appropriately delivered to charity when the investment is in the form of substantial ownership of an active business.

As I mentioned, many foundations argue they should be allowed to retain control of the business because no buyer would continue to operate the business in the same manner as the foundation. This appears to us to present an example of the adverse effects business involvement can have on the attention given by the managers to the charitable purposes. If operation of a business is substantially related to a charitable purpose the holdings of the business would not constitute excess business holdings. The inability to locate a taxable investor prepared to continue the business unchanged is an indication that the current method of operation is not the most economically sound and effective use of the funds invested in the business. Therefore, it appears that these foundations are asking Congress to condone the use of charitable assets to continue in operation a business in a manner that does not fully serve a charitable purpose.

With respect to the difficulties that may be faced by foundations as the statutory deadline approaches, we think the 10-, 15-, and 20-year requirements are ample and have given substantial periods of time for disposition in the case of pre-1969 holdings. In the case of business holdings received after 1969, however, the 5-year period for disposition may be a bit short where very large holdings are received and there is an unusually complex business arrangement. Therefore we are suggesting that the Congress might want to give the Commissioner authority to allow an additional 5 years for disposition where certain unusual circumstances are present in a gift to a foundation after 1969 of a large closely held business.

I will just mention the expenditure responsibility rules. The suggestion was made that the rules are unnecessarily arduous and administratively difficult. I agree there is a perception that that is true. The suggestion has been made that we should exempt smaller gifts under $15,000 from the expenditure responsibility rules. As we look at the rules in present law, which require a pregrant inquiry, an agreement with the grantee, and a report from the grantee that the funds have been used as stated, those rules seem only reasonable. It seems to me a foundation would want to carry on those safeguards in any event.

Perhaps the reporting of the activities on the tax return is burdensome and we might want to look at that. We would be happy to look at any specific requirements that this committee uncovers in these hearings where it might think the complexity of the expenditure responsibility rules could be lessened either administratively or legislatively. We don't think a straight exemption is the way to go at any level of grant size.

Finally let me just mention that there has been a lot of discussion of the excise tax on investment income of foundations. It was originally 4 percent in 1969. It was reduced to 2 percent at a later date. It is still slightly more than the amount necessary to pay for total government expenditures for administering the law with respect to all tax-exempt organizations including tax-exempt employee plans. We have difficulty justifying a tax on private foundations alone among the tax-exempt organizations to finance supervision of all exempt organizations.

So in conclusion, Mr. Chairman, our view of the rules adopted in 1969 indicates they are in general achieving their intended purposes. We would support review of a number of the existing rules to determine whether the administrative burden imposed on the foundation by the rules can be lessened without reducing the effectiveness of the rules and we would also support changes with respect to the definition of disqualified persons, a point I didn't mention in my oral statement. We would support extension of the 5-year period for dispositions of excess business holdings; and we would support extension of the 5-year carryover rule for charitable contributions.

While we are not prepared to support other changes at this time we think a further review of the 20 percent of AGI limit applicable to charitable contributions and the 2-percent excise tax on private foundations would be appropriate.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF HON. JOHN E. CHAPOTON, ASSISTANT SECRETARY (TAX POLICY), DEPARTMENT OF THE TREASURY

Mr. Chairman and Members of the Subcommittee, I am pleased to appear before you today to review with you the current rules governing private foundations.

Private foundations provide for diversity and flexibility in philanthropy. A donor, through a private foundation, may direct the use of funds which he gives to charity to those areas in which he has a particular concern or interest. Foundations, by reflecting the concerns, interests, and experience of their creators, have increased the diversity of charitable works. In addition, because the assets of private foundations are often not committed to specific operating programs, foundations are able to shift their financial support from one charitable area to another relatively easily. The existence of a pool of charitable funds that can be used to support new charitable ventures may encourage evolution and growth in the area of charitable activities.

The same factors that give foundations a unique role in philanthropy—influence of a small number of people and the existence of uncommitted funds—also create the potential for use of foundations for private benefit. While private foundations in general have been operated responsibly and for the public benefit, prior to 1969 serious abuses occurred among a minority of foundations. The existence of these abuses was damaging to charitable causes not only because they diverted money from charitable uses, but also because they generated adverse publicity and a negative public image for private foundations. To insure that charitable funds were devoted to charitable purposes, the Tax Reform Act of 1969 imposed a number of restrictions on private foundations.

We recognize that prevention of the diversion of charitable funds for private purposes has not been accomplished without cost. The private foundation rules impose certain administrative burdens on an organization, and in some cases may prevent a private foundation from taking advantage of an opportunity to participate in a transaction that would benefit the foundation. In evaluating the private foundation rules, it is important to weigh the detriment to charity from abusive use of private foundations against the detriment to charity from the imposition of restrictions on private foundations.

Some have claimed that the 1969 rules relating to private foundations are so restrictive and burdensome that they have caused a reduction in the number of existing foundations, a decline in the creation of new fundations, and a decline in the amount of charitable giving to foundations. We have found the available data on the birth and death rates of foundations and on charitable giving, both to foundations and to all charities, to be inadequate to determine whether there have been such declines. Our analysis of the rather limited information readily available on this matter indicates giving to foundations increased as a percentage of total charitable giving from 1974 to 1979. However, the data we have analyzed is defective in some respects as an indicator of the impact of the 1969 rules on private foundations.

BACKGROUND

The Federal government has used the tax system to encourage private philanthropy since 1917, when an income tax deduction for gifts by an individual to charity was first allowed. In addition to the allowance of deductions for charitable contributions, charitable activities are promoted through the tax system by the exemption from taxation of investment income earned by organizations that conduct such activities. These rules provide substantial tax benefits to charitable organizations. The preferential treatment given to charitable contributions and charitable organizations is justified on the ground that charitable organizations provide significant benefits to the public.

While in most cases charitable organizations have used their assets solely for charitable purposes, over the years experience has shown that certain types of charitable organizations have sometimes been used for private benefit, often with little benefit going to charity. Congress first addressed the problem of the use of charitable assets for noncharitable purposes in the Revenue Act of 1950. That Act denied tax-exempt status and disallowed deductions for contributions to certain organizations that engaged in specified financial transactions with related persons, accumulated unreasonable amounts of income, used accumulated income for noncharitable purposes, or invested accumulated income in a manner that jeopardized the carrying out of their charitable function. Religious organizations and certain related organizations, educational organizations, publicly or governmentally supported organizations, and organizations having the principal purpose of providing medical or hospital care or medical education or medical research were not subject to these rules. There organizations, because of their "public" character, were not believed likely to become involved in the prohibited transactions.

Unfortunately, these provisions did not prove to be sufficient to prevent abuses. The principal reason for the ineffectiveness of these provisions was the administrative difficulties created by the vagueness of the statutory standards. For example, financial transactions with related persons were prohibited only if they did not satisfy certain arm's length standards. Thus, the Internal Revenue Service was required to make determinations of the adequacy of security for a loan, the reasonableness of interest, the excessiveness of salaries, the preferential basis for making services available, and the adequacy of consideration. Such determinations are not easily made.

A secondary problem with the 1950 provisions was that the penalty—loss of exemption and denial of deductions for contributions—was so severe that it was imposed only sparingly. In addition, loss of exemption punished the charitable organization, and thus the charitable endeavors it might benefit, rather than the related persons who had used the organization for personal benefits.

At the request of the tax writing committees of Congress, the Treasury Department conducted a study of private foundations which resulted in the 1965 Treasury Department Report on Private Foundations. This Report concluded that charitable assets were being used to a substantial extent for noncharitable purpose. These noncharitable uses included self-dealing between foundations and donors, undue delay in the delivery of benefits to charity, extensive foundation involvement in business resulting in noncharitable use of charitable assets, family use of foundations to control corporate and other property, and financial transactions unrelated to charitable functions. Some of these abuses had been addressed by legislation prior to 1965, but the Treadury Report found the existing rules to be ineffective and extremely difficult to administer.

The private foundation rules enacted in the Tax Reform Act of 1969 were, in large part, a response to the problems described in the 1965 Treasury Report. I would like to describe briefly these private foundation rules, the abuses at which they were directed, and the reasons specified for the particular form in which the rules were enacted.

GENERAL DESCRIPTION

Self-dealing

Congress addressed the problem of self-dealing in the Revenue Act of 1950 by denying tax-exempt status to an organization that engaged in financial transactions with donors (or certain related persons) on terms that were unfair to the foundation. The 1965 Treasury Report provides many examples of self-dealing acts engaged in prior to 1965. It also describes the difficulties encountered in applying the standards of fairness set forth in the 1950 amendments and the reluctance of courts to apply the severe sancation of denial of exemption. In addition, the 1965 Treasury Report concluded that even transactions which are conducted on fair terms may nevertheless benefit the donor and harm the foundation. For example, a donor benefits from being able to obtain a loan from the private foundation, even on fair terms, because the donor may be confident the funds will be made available to him when he needs them with little disclosure of the donor's personal affairs. The foundation and charitable beneficiaries may suffer a detriment because the donor's desire to have funds available for his borrowing may influence decisions on investments and distributions made by the foundation.

In view of the problems with administering the prior law, and the possibilities for benefit to the donor and detriment to the foundation even in a transaction conducted on arm's length terms, Congress decided in 1969 to prohibit even arm's length transactions between a private foundation and a donor (and certain other persons related to the foundation). The self-dealing prohibitions take the form of a penalty tax imposed on the person engaged in an act of self-dealing with the foundation and on foundation managers who participate in the transaction knowing it to be an act self-dealing.

The related persons who are subject to the prohibition are known as "disqualified persons." These include substantial contributors, foundation managers, an owner of more than 20 percent of an entity that is a substantial contributor, members of the family of any of the foregoing, entities that are more than 35 percent owned by any of the foregoing, and (for purposes of the self-dealing rules only) government officials. Members of an individual's family for these purposes are the individual's spouse, ancestors, lineal descendants, and spouses of lineal descendants.

Delay in delivery of benefits to charity

A second problem that was addressed by Congress in the Revenue Act of 1950 was substantial delay often occurred between the making of a charitable contribution and actual delivery of benefits to the public. Contributions to private foundations are often retained by the foundation as principal, and then used to generate income which is available for charitable purposes. The 1965 Treasury Report documents a number of cases, however, in which contributions were invested in such a manner that little, if any, income was produced, or income received on investments was accumulated for long periods of time without significant distribution being made for charitable purposes. In these situations, the benefit to charity from the contributed assets was delayed for indefinite periods of time.

The undesirability of extended delays in providing benefits must be weighed against the role of endowment funds in charitable activities. The existence of such funds, which are dedicated to charitable purposes but not committed to any particular operating program, permits the funding of new and innovative charitable endeavors that might otherwise have difficulty obtaining the support necessary to begin operations. To date, Congress has concluded that the special role played by private foundations is sufficiently important to justify the delay in providing public benefits that is inherent in endowment funds. However, Congress has also determined that unreasonable delays resulting from failure to earn a reasonable rate of return on endowment funds or from long-term accumulations of income are not justifiable.

The Revenue Act of 1950 denied tax-exempt status to certain organizations that accumulated income in an unreasonable amount or for an unreasonable period of time. As with the prohibitions on self-dealing enacted in 1950, this rule proved to be insufficient to prevent delays in the delivery of charitable benefits, primarily because of the difficulties in administering a standard based on the term "unreasonable." Therefore, in 1969, Congress replaced this subjective standard with an objective requirement that a private foundation make distributions for charitable purposes in an amount at least equal to the greater of its adjusted net income or a minimum rate of return on the value of its investment assets. A distribution for charitable purposes will not satisfy this distribution requirement if it is made to an organization controlled by the foundation (or its disqualified persons) or to a private foundation other than a foundation (know as an "operating foundation") which distributes substantially all of its income directly for the active conduct of charitable activities.

The minimum rate of return was set at 6 percent for 1970 and was to be adjusted annually thereafter based on changes in money rates and investment yields. The foundation community objected to this formula, claiming it established an unrealistically high rate of return. In response to these concerns Congress, in the Tax Reform Act of 1976, fixed the minimum rate of return at 5 percent, with no provision for subsequent adjustment. As inflation rates climbed, foundations became concerned that the requirement that they distribute the full amount of their adjusted net income was eroding the real value of their endowment. In response to this concern, Congress, in the Economic Recovery Tax Act of 1981, eliminated this requirement. The current law, then, requires a foundation to distribute currently an amount equal to 5 percent of the value of its investment assets. The penalty for failure to make the required distributions is an excise tax imposed on the foundation.

Ownership of active businesses

A significant area of abuse which was highlighted in the 1965 Treasury Report, but with respect to which Congress had not passed any prior legislation, was the ownership of active business enterprises by foundations. Extensive private foundation ownership of a business was found by the 1965 Treasury Report to raise a number of problems. A business that is owned by a tax-exempt entity often has a competitive advantage over a similar business owned by a taxable persons. Changes made in 1969 in the taxation of unrelated business income removed many potential competitive advantages for businesses owned by tax-exempt entities. Congress, however, decided that these changes did not remove all of its concerns with foundation ownership of active businesses. For example, the rate of return that a tax-exempt entity must demand from its investment in a business may be lower than the rate of return that a taxable investor would demand. A private foundation, which receives not only dividends from the business but also income from other investments tax-free, and which may also receive tax deductible contributions, may be in a position to allow the business to retain earnings for expansion where a taxable owner would require distributions of earnings. The 1965 Treasury Report noted a common willingness of foundations to defer indefinitely the realization of profits from investments in commercial operations. Such deferral not only provides a competitive advantage to the business, the 1965 Treasury Report found, but also results in deferral of benefits to charity.

Another problem described in the 1965 Treasury Report with respect to foundation control of a business enterprise is that control provides such a broad spectum of opportunities for the foundation's assets to be used for the benefit of private individuals that it is impossible to prohibit all potential acts of self-dealing legislatively. For example, a business acquaintance of the donor may be accommodated in the structuring of transactions with the foundation controlled business. It would be impossible to determine whether such accommodation was made because, as a matter of sound business judgment, it appeared in the best interests of the controlled business or because the donor wished to benefit the business acquaintance.

Finally, the 1965 Treasury Report pointed out that substantial ownership of a business by a private foundation may be detrimental to charity because the attention of the foundation's managers may be drawn away from charitable pursuits. When a foundation owns a substantial portion of a business, it is incumbent upon the foundation managers to insure that its investment in the business is being properly managed and that the business is as successful as possible. Thus, even where the actual management of the business is the responsibility of individuals who are unrelated to the foundation, the foundation managers are obliged to be informed about and responsive to the condition of the business. The demands that ownership of a business imposes on the foundation managers' time reduces the time and attention the foundation managers devote to their charitable duties. Where the investment of a foundation in a business is substantial, the foundation managers' primary concern may become the welfare of the business. As explained in the 1965 Treasury Report, this distraction of foundation managers from the charitable activities of the foundation eliminates one of the factors—concentration of the energies and experiences of donors on accomplishing charitable work—that makes private foundations of unique value to philanthropy.

The 1965 Treasury Report provides a number of examples of the problems described above relating to foundation ownership of businesses. In recognition of these problems, Congress in 1969 prohibited foundations, alone or in combination with disqualified persons, from owning substantial portions of any active business enterprise. Transition periods of up to 20 years were provided to allow for initial dispositions by foundations having substantial holdings in 1969, with an additional 15-year period provided before final dispositions must be made. The penalty for owning business holdings in excess of the permitted amounts is an excise tax on the foundation.

Speculative investments

In addition to the need for a foundation to produce a reasonable rate of return on investments, protection of corpus is necessary to further charitable purposes. The 1965 Treasury Report described the participation of some foundations in securities trading and highly speculative investments and concluded that the exposure of charitable assets to the high risk of loss associated with such investments was not appropriate. For this reason, Congress in 1969 extended the prohibition on investing income in a manner that jeopardizes charitable purposes to investments of corpus as well. As with the other rules enacted in 1969, the penalty for violation of this prohibition is an excise tax.

Expenditures for noncharitable purposes

The Revenue Act of 1950 amended the 1939 Code to deny tax-exempt status to certain organizations that used accumulated income to a substantial degree for noncharitable purposes. However, Congress determined in 1969 that despite this prohibition foundation funds were being used for activities that should not be carried on by exempt organizations. For example, foundation funds were being used for direct participation in legislative activity, despite the fact that charitable organizations had been prohibited since 1934 from engaging to a substantial extent in legislative activity. In addition, although direct participation in a political campaign on behalf of a candidate was prohibited by the 1954 Code, the 1969 Congress found that indirect participation in political campaigns often occurred through financing registration campaigns or making contributions to other organizations that used the money to influence opinions about candidates. Other situations were brought to the attention of Congress in which "educational" grants had been used to take vacations abroad, to enjoy paid interludes between jobs, and to subsidize the preparation of materials furthering specific political viewpoints. In general, Congress was concerned that in many cases foundations exercised little or no control over the use of funds by grantees.

It was concluded that grant-making foundations should take substantial responsibility for the proper use of the funds they give away. To accomplish this result, the Tax Reform Act of 1969 imposed an excise tax on foundations that make taxable expenditures, which are defined as expenditures, whether made directly or indirectly, for legislative or political purposes, for a grant to an individual for travel or study, unless the grant satisfies certain conditions, for a grant to an organization other than a public charity unless the foundation exercises certain precautionary measures (known as "expenditure responsibility") to insure the proper use of the funds, or for any noncharitable purpose. Again, the penalty takes the form of an excise tax.

Definition of private foundation

The Tax Reform Act of 1969 provided the first statutory definition of the term "private foundation." Prior to that time, the term had not been statutorily defined but had commonly been used to describe generally an organization contributions to which could be deducted only to the extent of 20 percent of an individual donor's adjusted gross income. While the general rule allowed deductions of charitable contributions only to the extent of 20 percent of adjusted gross income, beginning in 1954 contributions to certain specified charitable donees could be deducted to the extent of 30 percent of the donor's adjusted gross income. In 1969, these specified organizations included churches, schools, hospitals, medical research organizations operated in conjunction with hospitals, publicly or governmentally supported fund-raisers for schools, governmental units, and charities that received a substantial part of their support from governmental units or the general public. The 1969 Congress determined that the problems it was seeking to address in the private foundation rules were not likely to occur among these specified charitable organizations. Therefore, in designing the 1969 restrictions on private foundations, Congress excluded all such organizations from the statutory definition of private foundation. In addition, Congress determined that certain other publicly supported organizations, and organizations that support and are operated, supervised, or controlled by or in connection with a charitable organization that is not a private foundation, were sufficiently responsive to the general public that such organizations could also be excluded from the definition of private foundation. The charitable organizations that are excluded from the statutory definition of private foundation are generally referred to as "public" charities.

Excise tax

In recognition of the fact that the new rules relating to private foundations would impose a substantial administrative burden on the government, Congress imposed an excise tax on private foundations to cover the costs associated with government supervision of exempt organizations. This excise tax was originally set at 4 percent of the adjusted net income of a foundation. Based on evidence that the revenue from the tax exceeded the government's costs, Congress in 1978 reduced the tax to equal 2 percent of adjusted net income.

Limitations on contributions

One further change affecting private foundations was made by the Tax Reform Act of 1969. As described above, prior to 1969 charitable contributions to churches, schools, hospitals, medical research organizations operated in conjunction with hospitals, publicly or governmentally supported fund-raisers for schools, governmental units, and charities that received a substantial part of their support from governmental units or the general public could be deducted to the extent of 30 percent of the donor's adjusted gross income. Gifts to all other charities could be deducted to the extent of 20 percent of a donor's adjusted gross income. An exception to these limitations permitted unlimited deductions by a donor who had contributed to charity substantially all of his taxable income for 8 of the preceding 10 taxable years. In the Tax Reform Act of 1969, Congress repealed this exception, increased the 30 percent limit to 50 percent, and added to the list of 50-percent charities operating foundations, publicly supported organizations not previously on the list, organizations that support 50-percent charities, and private foundations that distribute for charitable purposes, within 2½ months after the close of the year in which contributions are received, the full amount of all contributions received in such year.

ANALYSIS OF THE 1969 RULES

The 1969 rules relating to private foundations are an improvement over prior law in at least two respects. First, the imposition of a penalty tax on the persons responsible for improper activities is a great improvement over denial of tax exemption as a penalty. The severity of the prior penalty was often disproportionate to the wrongdoing, making both the Internal Revenue Service, and the courts reluctant to impose it. In addition, the penalty often punished the charity rather than the persons who used a foundation for their own personal benefit. Second, the objective standards provided in the current rules establish clear guidelines for compliance by foundations and make administration by the Internal Revenue Service much easier than under prior law.

We recognize that these restrictions may in some cases prevent a foundation from engaging in a transaction, making an investment, or making a grant that the foundation managers believe would serve charitable purposes. However, the beneficial effects of having clear standards must be taken into consideration in evaluating the overall desirability of these rules. Any such evaluation should take into account the evidence presented in the 1965 Treasury Report on the potential detriment to charity in the absence of clear and administrable rules prohibiting use of charitable assets for private purposes.

SUGGESTIONS FOR CHANGE

I would now like to discuss a number of changes to the private foundation rules that have been suggested by various persons.

Charitable contributions limitations

Several distinctions exist in the deductibility of contributions to private foundations and contributions to public charities. As I have discussed, contributions to private foundations are generally deductible, for income tax purposes, only to the extent of 20 percent of the donor's adjusted gross income. In contrast, contributions to public charities may be deducted to the extent of 50 percent of the donor's adjusted gross income.

The amount of the income tax deduction allowed for a contribution to a private foundation of appreciated property is the fair market value of the property reduced by the amount of the gain (now 40%) that would have been long-term capital gain included in the donor's taxable income if the property had been sold at its fair market value. In contrast, the full fair market value of a similar contribution to a public charity would be deductible.

In addition, contributions to public charities in excess of the 50-percent limitation may be carried over to and deducted, subject to the 50-percent limit, in each of the donor's 5 taxable years following the year of the contribution. No such carryover is provided for contributions to private foundations in excess of the 20-percent limitation.

Congress first distinguished between contributions to public charities and contributions to private foundations when it enacted the Internal Revenue Code of 1954, when the limitation on contributions to churches, schools, or hospitals was increased from 20 percent to 30 percent. The stated purpose of this change was to aid the specified institutions of obtaining the additional funds they needed, in view of their rising costs and the relatively low rate of return they were receiving on endowment funds. In 1956, medical research organizations operated in conjunction with hospitals were added to the list of preferred charities. In 1962, publicly supported fund-raising organizations for schools were added to the list of 30-percent charities.

In 1964, the benefit of the 30-percent limit was extended to publicly or governmentally supported organizations and governmental units. By way of explanation, the Committee Reports stated that the extra 10 percent deduction was intended to encourage "immediately spendable receipts of contributions for charities organization." The Senate Finance Committee Report specifically noted that the additional 10 percent deduction was not allowed for contributions to private foundations, stating that such organizations "frequently do not make contributions to operating philanthropic organizations for extended periods of time and in the meanwhile use the funds for investments."

The last addition to the list of preferred charities was made by the Tax Reform Act of 1969. At that time, the limitation on contributions to such organizations was increased to 50 percent and the list of preferred organizations was expanded to include all charities that were not private foundations, all operating foundations, and foundations that distribute all contributions to public charities or operating foundations within 2½ months following the close of the year of receipt.

Thus, there exists a longstanding policy that contributions to certain essential service organizations (schools, hospitals, churches, and related organizations) and to charitable organizations that can be expected promptly to spend contributions directly in the conduct of charitable activities are to be preferentially encouraged. The foundation community has identified the more restrictive limitations on the deductibility, for income tax purposes, of contributions to private foundations as a major factor inhibiting growth of private foundations, and has suggested that lifetime contributions to foundations should receive the same treatment as contributions to public charities.

We are prepared to recommended a change in the basic policy that lifetime contributions to public charities should be preferentially encouraged without substantial evidence that private foundations are suffering serious adverse effects as a result of the limitations placed on the deductibility of contributions to them. As described earlier, the Treasury Department has not seen any reliable data to support the claim of the foundation community that the limitations on deductibility of lifetime gifts to private foundations are seriously reducing contributions to foundations. In fact, the data we have reviewed seems to indicate an increase in the share of total charitable giving going to private foundations in recent years.

We note that the current rules do not absolutely favor public charities over private foundations. Rather, they ensure that if a taxpayer is permitted to deduct from his income charitable contributions in excess of 20 percent of his adjusted gross income, a share of those contributions should go to organizations providing essential services or at least providing immediate rather than delayed benefits. While we are reluctant to support elimination of the distinctions between contributions to public charities and contributions to private foundations, we would be happy to work with the Subcommittee to determine whether some other adjustment to the 20 percent limit might be appropriate.

We oppose the proposal that donors be allowed to deduct the full fair market value of appreciated property contributed to a private foundation. The income tax charitable contribution deduction is generally intended to permit a donor to make a charitable contribution with pretax dollars. When a donor contributes appreciated property, he is not required to include the gain on the property in income. Therefore, to the extent the value of the gift represents appreciation in the hands of the donor, the gift is already being made with pretax dollars. If the donor is also allowed to deduct the full value of the property as a charitable contribution, he receives substantially increased tax benefits, since deduction of the amount of the appreciation reduces his taxable income from other sources. In addition, the full deductibility of appreciation provides increased potential for abuse through overvaluation of assets.

Congress has chosen to provide this greater tax benefit only with respect to contributions to public charities. We believe it is appropriate to continue to limit this additional benefit to contributions to public charities. We continue to have concerns about the valuation problems even in this context.

With respect to the 5-year carryover provision, we see no benefit to charity from requiring a donor to a private foundation to postpone making a portion of a contribution until later years rather than making one large gift and carrying the excess contribution deduction over to later years. Therefore, we would support extension of the 5-year carryover rule to contributions to private foundations.

Excess business holdings

Perhaps the most criticized provision of the 1969 private foundation rules is the excess business holding provisions which prohibits substantial business holdings by private foundations. A number of foundations have suggested that the excess business holdings rules are unnecessary and are detrimental to charity. They argue that the prohibition on self-dealing and the minimum distribution requirement are sufficient to prevent abuses. In some cases, foundations maintain that disposition of their excess business holdings would be detrimental to charity because the approaching deadline for disposition increases the opportunity to buy a business from a foundation at a low price. Other foundations wish to retain their excess business holdings because they cannot find a buyer who will continue to operate the business in the same manner in which, or at the same location as, it is operated by the foundation. Each of these foundations argues that the business as they operate it provides special benefits to the community, for example employment opportunities or continuation of a particular type of business that is disappearing under pressures of modernization, that justify continued ownership by the foundation.

The Treasury Department opposes elimination of the restrictions on excess business holdings. We do not consider the prohibition on self-dealing and the minimum distribution requirement to be sufficient to prevent the problems associated with foundation ownership of businesses. The self-dealing rules prohibit a specific list of transactions with disqualified persons. The possibilities for conferring private benefit through a controlled business are numerous and in many cases very subtle. We do not believe it is possible to draft a statutory prohibition of all possible acts of self-dealing involving a foundation controlled business. Even if all possible transactions could be identified, the prohibition of all such transactions with persons a disqualified person might wish to benefit would unreasonably interfere with operation of the business. In addition, administration of such a prohibition would be virtually impossible.

The minimum distribution requirement may be ineffective in preventing substantial delays in the delivery of benefits where a foundation owns a substantial interest in a business enterprise. It is very difficult in many cases to value a closely held business. Since the minimum distribution requirement depends on the value of the foundation's investment assets, the lack of an accurate valuation substantially undermines the effectiveness of the requirement. Even where valuation is not a problem, the minimum distribution requirement does not prevent deferral of benefits to charity. As discussed above, the minimum distribution requirement has been set at 5 percent to permit a foundation to preserve corpus in times of inflation. Many investments a foundation might make earn substantially more than a 5 percent rate of return. The result is that a foundation may receive a negligible return from one investment, such as a controlled business, and still be able to satisfy its minimum distribution requirement out of income from other investments. Even if a foundation's only investment is in the business, the 5 percent distribution requirement would permit the foundation to accept a 5 percent return, which will be a relatively low rate of return at times, while allowing the remainder of the earnings to accumulate in the business. For these reasons, we do not consider the minimum distribution requirement sufficient to ensure that the benefits of an investment of charitable funds are reserved for and promptly delivered to charity when the investment is in the form of substantial ownership of an active business.

Those foundations that argue they should be allowed to retain control of a business because no buyer would continue to operate the business as the foundation does appear to us to present examples of the adverse effects business involvement can have on the attention given by foundation managers to charitable purposes. If operation of a business is substantially related to a charitable purpose, then holdings in the business would not constitute excess business holdings. The inability to locate a taxable investor who is prepared to continue the business unchanged is a strong indication that the current method of operation is not the most economically sound and effective use of the funds invested in the business. Therefore, it appears that foundations using this argument are asking Congress to condone the use of charitable assets to continue in operation an inefficient business that does not serve a charitable purpose.

With respect to the difficulties that may be faced by a foundation as the statutory deadline for disposition of excess business holdings approaches, we believe that the 10, 15, or 20 year transition periods provided for initial dispositions of pre-1969 holdings are sufficient. In contrast, we believe there may be limited situations in which the 5-year disposition period for post-1969 gifts or bequests of excess business holdings may be insufficient. Our concern in this area is not with take-overs, but with the need to provide sufficient time to dispose of holdings at a fair price. Dispositions of unusually large gifts of business holdings that are unusually complex may require a longer period of time because of the complexity and size of the transaction. The Treasury Department is prepared to support a provision that would permit the Secretary to grant an additional 5 years for disposition in such cases, provided certain conditions are met.

For the reasons discussed above, Treasury opposes any changes in the basic excess business holdings rules except a change to allow, under limited circumstances, an additional 5 years for dispositions of post-1969 excess business holdings.

Definition of disqualified persons

Criticism of the definition of disqualified persons has centered on its inclusion of all lineal descendants (and spouses of lineal descendants) of a disqualified person. After several generations, it becomes a substantial administration burden for a foundation to keep track of all lineal descendants of a substantial contributor. The foundation community suggests that at some point the connection between the foundation and a lineal descendant of a substantial contributor becomes so attenuated that it is no longer necessary to treat the descendant as a disqualified person. Recent legislative proposals have suggested that it would be sufficient to include just children and grandchildren in lineal descendants who are disqualified persons by reason of being members of a disqualified person's family.

The Treasury Department agrees that the administrative burden of keeping track in perpetuity of all lineal descendants of a substantial contributor cannot be justified by the benefits to be obtained from application of the private foundation rules to distant relatives. However, we believe that the inclusion of children and grandchildren in the definition of family members would be too limited.

We would propose that the definition of family members be redefined, with respect to lineal descendants (and their spouses), to include only lineal descendants born on or before the date of the disqualified person's death, lineal descendants that hold, within 15 years after the date of death of the disqualified person, an interest in a business in which the foundation owns more than a 2 percent interest, all lineal descendants of the foregoing during their lifetime, and spouses of the foregoing.

EXPENDITURE RESPONSIBILITY

A private foundation that makes a grant to an organization other than a public charity must exercise expenditure responsibility with respect to the grant to avoid the penalty tax imposed on taxable expenditures. Expenditure responsibility is defined in the statute to mean that "the private foundation is responsible to exert all reasonable efforts and to establish adequate procedures—(1) to see that the grant is spend solely for the purpose for which made, (2) to obtain full and complete reports from the grantee on how the funds are spent, and (3) to make full and detailed reports with respect to such expenditures to the Secretary."

The proposal has been made that private foundations be exempted from exercising expenditure responsibility with respect to grants of $15,000 or less. The foundation community argues that expenditure responsibility is not needed for small grants because there is a basic requirement for exemption that a charitable organization making grants to noncharitable organizations must make every reasonable effort, including requiring periodic reports from grantees, to ensure that grant funds are spent for designated charitable purposes. We note that this requirement was in effect prior to 1969 and was not sufficient to prevent the abuses that caused Congress to enact the current expenditure responsibility rules. In part, the effectiveness of a general rule for tax exemption is limited because its enforcement requires more extensive audit activity than the resources of the Internal Revenue Service permit. In addition, the penalty for violation of such a general rule is loss of exemption. The severity of this penalty makes both the courts and the Internal Revenue Service reluctant to invoke it. The excise tax provided for failure to exercise expenditure responsibility is a more realistic penalty.

The Treasury Department does not believe that the expenditure responsibility rules, in general, impose an undue administrative burden on foundations. The statutory requirements are simply that a foundation that makes a grant to a noncharitable organization or to a private foundation take reasonable steps to determine that the charitable funds will be spent for charitable purposes, obtain reports from the grantee on how the grant is spent, and report to the Secretary on the grant. Any responsible foundation would consider the first two steps essential if it were to turn over charitable funds to a noncharitable grantee. The requirement of a report to the Secretary is an enforcement mechanism.

We believe consideration should be given to whether the requirement of a report to the Secretary serves a sufficient purpose to justify the added administrative burden it imposes on a private foundation. Aside from this, our review of the statutory provisions and the implementing regulations has not revealed requirements that are any greater than necessary to assure that foundation grants are properly used. We understand foundations that have exercised expenditure responsibility have found the requirements to be relatively easy to satisfy. Therefore, we believe that problems in this area are more a matter of mistaken understanding than actual defects in this statute.

In the event that specific problems encountered in complying with expenditure responsibility are brought to the attention of this Subcommittee, we would like to work with the Subcommittee to see if such problems can be solved administratively or through legislation. Such an approach would be preferable to any blanket exemption from expenditure responsibility.

FIRST-TIER PENALTY TAX

The penalties imposed under the various private foundation rules are in the form of an initial (or first-tier) tax and an additional (or second-tier) tax. In general, the first-tier tax is 5 to 15 percent of the amount involved in a violation of the private foundation rules. The second-tier tax is substantially larger, ranging from 25 to 200 percent of the amount involved, and is not assessed (or is abated or refunded) if the violation is corrected during a specified correction period. There is no provision for abatement of the first-tier tax.

Recent proposals have suggested that the first-tier taxes should be abated if the Secretary determines that a violation was due to a good faith error or omission and not due to intentional disregard of rules and regulations, and the violation is corrected within the correction period. The 1969 rules were designed to provide clear standards for determining when a violation occurs and to impose automatically a penalty on any violation. The knowledge that the penalty for a violation must be paid in all events was intended to encourage foundation managers to familiarize themselves with the rules and exercise care to avoid violations. A rule which permitted abatement of the first-tier tax for inadvertant errors would undermine the rules by allowing foundations that have exercised less scrutiny of their activities to avoid the first-tier taxes.

It should be noted that the rules for imposing the first-tier penalty taxes already take into account the possibility that a foundation acting in good faith and with due diligence may have been involved in a violation. For example, under the self-dealing rules, no tax is imposed on the foundation in any event, and a tax is imposed on a foundation manager only in the case of participation in an act which he knew to be self-dealing. Thus, only the disqualified person who deals with a foundation, not the foundation or the foundation managers, faces any risk of imposition of a penalty tax for an indvertant act of self-dealing. Under the minimum distribution provisions, the tax for a failure to distribute is imposed on the private foundation. However, an exception is provided for violations due to an incorrect valuation of assets that was not willful and was due to reasonable cause.

We do not see the need for a general provision allowing abatement of first-tier taxes in cases of good faith errors. However, if specific situations in which knowledgeable and careful foundation managers might reasonably be expected to encounter difficulties in complying with the rules are brought to the attention of this Subcommittee, we would be pleased to consider whether additional specific exceptions to imposition of the first-tier penalty taxes should be provided.

Public support

A variety of organizations that have been publicly supported charities for a number of years have built up substantial endowments from contributions from the general public. These endowments produce so much income that the organizations are no longer able to obtain even 10 percent of their support from contributions. Therefore, they are no longer able to be classified as public charities by reason of receiving a substantial part of their support from the general public. These organizations have requested that they be allowed to qualify as public charities despite their inability to satisfy the public support tests.

The reason publicly supported organizations are treated as public charities rather than private foundations is that it is expected that they must be responsive to the public in order to continue receiving public support. When an organization receives less than 10 percent of its support from the general public, we do not believe it can be assumed that it will continue to be responsive to the general public. In the absence of public support, an organization should possess some other factors that would indicate public responsiveness. For example, Congress may wish to consider whether an organization that expends substantially all of its income for charitable purposes and that has a board of managers, the membership of which is appointed by public officials and changes regularly, might be sufficiently responsive to public opinion to qualify as a public charity.

Therefore, we would consider supporting an exemption from the minimum 10 percent of support test only with the addition of a requirement that an organization possess other indications of public responsiveness.

RELIANCE ON IRS DETERMINATIONS

Private foundations must exercise expenditure responsibility with respect to grants made to another private foundation. In addition, distributions to a nonoperating private foundation may not be used to satisfy the foundation's minimum distribution requirements unless the amount of the contribution is distributed by the donee foundation for charitable purposes within one year after the year of receipt. Therefore, in order to avoid violations of the expenditure responsibility rules and the minimum distribution rules, a private foundation must determine whether a potential donee is a private foundation or public charity.

In many cases the public charity status of a donee is determined by the percentage of its support that is received from the general public. The Internal Revenue Service issues determination letters to all charities relating to their status as public charities. For new organizations without four years of support history, advance rulings are issued based on a determination that the charity can reasonably be expected to meet the public support test during an advance ruling period of either 2 or 5 years. In general, a donor is permitted to rely on an IRS determination of a donee's public charity status until publication of notice of a change of status. However, reliance is not permitted where the donor has knowledge that the IRS has given the donee notice that its status would be changed or where the donor is responsible for or aware of a substantial and material change in the donee's support which causes the donee to lose its public charity status.

The foundation community has suggested that the administrative burden of reviewing financial information provided by donees to determine their public charity status is unreasonable. Concern has also been expressed that new organizations that are most in need of support from private foundations have so little support from the general public during their first two or three years of existence that it is difficult for a private foundation to obtain assurance that a grant will not cause the organization to fail to qualify for public charity status. For these reasons, the proposal has been made that private foundations be allowed to rely on IRS determinations of public charity status until notice of a change in a donee's status is published or the foundation acquires actual knowledge of notice to the donee of a change in status. The only exception to this rule would be if the foundation were responsible for (other than by making a grant or grants) or aware of a change in the donee's public charity status.

We believe that it is appropriate to require foundations to inquire whether its grant would cause the donee to lose its public charity status. Therefore, we would oppose permitting reliance on IRS determinations of public charity status without any inquiry about the potential effect of a grant on the donee's status. We agree that the donor foundation should not be required to become an auditor of the donee's financial records. The current requirements, which permit a foundation to rely on financial statements provided by donees, do not require such audit activity. However, we would be happy to consider whether further efforts could be made to minimize the administrative burden associated with inquiries about a donee's public charity status. In particular, we believe an examination of the situation facing a foundation making a grant to a newly organized charity deserves further attention.

Excise tax on investment income

The 2 percent excise tax imposed on a private foundation's adjusted net income was intended to provide the government with funds to cover the administrative costs associated with tax-exempt organizations. While it is difficult to determine the total costs incurred by the government in supervising tax-exempt organizations, we believe the 2 percent excise tax produces revenues slightly in excess of total government expenditures related to all tax-exempt organizations (including tax-exempt employee plans).

We recognize the justification for requiring taxpayers, including those that are otherwise exempt from taxation, to share the burden of administrative costs incurred by the government solely to supervise their activities. However, we have some difficulty justifying a tax on private foundations alone among tax-exempt organizations to finance supervision of all exempt organizations.

CONCLUSION

In summary, our review of the private foundation rules adopted by the Congress in 1969 indicates they are, in general, achieving their intended purposes. Among the various proposals for change that have been made, we would support review of a number of the existing rules to determine whether the administrative burden imposed on foundations by the rules can be lessened without reducing the effectiveness of the rules. We would also support certain changes with respect to the definition of disqualified persons, extension of the 5-year period for dispositions of excess business holdings received by bequest or gift, and application of the 5-year carryover rule to contributions to private foundations. While we are not prepared to support other changes at this time, we believe further review of the percentage limit applicable to charitable contributions to private foundations and the 2 percent excise tax on private foundations would be appropriate.

I would be happy to answer your questions.

Chairman RANGEL. Thank you, Mr. Secretary. Unless you have a scheduling problem we would like to hear from the Service first.

Mr. CHAPOTON. Very good.

Chairman **Rangel**. The Chair recognizes the Commissioner is ill and we wish him a speedy recovery. We welcome James Owens, the Acting Commissioner.

STATEMENT OF JAMES I. OWENS, ACTING COMMISSIONER, INTERNAL REVENUE SERVICE, ACCOMPANIED BY S. ALLEN WINBORNE, ASSISTANT COMMISSIONER FOR EMPLOYEE PLANS AND EXEMPT ORGANIZATIONS, AND HOWARD M. SCHOENFELD, SPECIAL ASSISTANT FOR EXEMPT ORGANIZATION MATTERS

Mr. **Owens**. Thank you, Mr. Chairman, and members of the subcommittee.

With me I have Mr. S. Allen Winborne and Mr. Schoenfeld. Mr. Winborne is Assistant Commissioner for Employee Plans and Exempt Organizations and as such the principal person responsible for administering the exempt organization program. He is deeply involved in the day-to-day operations of the exempt organization program.

I will attempt to summarize my statement and ask that the entire statement be put in the record.

Chairman **Rangel**. Without objection.

Mr. **Owens**. The Tax Reform Act of 1969 did create shockwaves in the philanthropic community. Early commentators on the private foundation provisions suggested the rules were so complex and punitive and burdensome that most of the foundations would terminate and few new ones would be created. One writer called the Tax Reform Act of 1969 a "death blow to foundations," another called the act a "calculated attempt to drive foundations out of business through the almost insuperable difficulty of ascertaining what the new law means."

Yet another echoing the same charges called for immediate repeal. Administratively, some questioned the ability of the Service to interpret and enforce legislation so complex and so cumbersome, and others were concerned that the law represented an invitation to onerous Federal and State regulations.

The Service was well aware of these charges and the fears. It is our considered judgment that time and experience have proven them to be groundless. We believe that the 1969 Tax Reform Act has proven itself to be fair, to be effective, and generally accomplishing the purposes Congress had in mind when enacting it without stifling the philanthropics from advancing the causes for which they exist.

Mr. Chairman, there are three major factors which I think I can point to as being responsible for some of the general success of the legislation and where the Service played a part. They are the foundation regulations promulgated by the Treasury Department under chapter 42 and related provisions; the Service's ruling program and taxpayer education efforts since 1969; the Service audit activities in the foundation area is a third.

I would like to touch on each separately.

The regulations reflect a clear and deliberate policy to give foundations basic freedom and flexibility to operate to fulfill their philanthropic goals and missions. To be sure, many changes were required and all the foundations had to find new ways of doing business but the regulations sharpened the focus of chapter 42 to actual and potential wrongdoers. The regulations struck an appropriate balance between accommodating legitimate foundation concerns and protecting against potential abuses.

The drafters of the regulations, aware of those shockwaves felt by enactment of the law, made certain to provide flexible and reasonable transitional rules allowing foundations and their managers and contributors an opportunity to become acclimated to a new way of life under the new law. The Service is satisfied that the regulations appropriately embody the act's effects, preserving the act's in terrorem effect, preserving the tension created in the legislation between permitted areas of charitable ventures and proscribed areas of conduct and creating strong incentives for self-regulation.

As envisioned by Congress and consistent with the concept of stewardship of charitable assets, effective enforcement of chapter 42 is not measured by tax dollars assessed against and collected from private foundations. Indeed, the most punitive of the penalty provisions is abated where it is shown the assets of an involuntarily terminated foundation will be used for charitable purposes.

Appropriate correction and preservation of assets for charitable uses are the ultimate goals set by Congress. Prior to the Reform Act, the code provisions dealing with exempt organizations could be administered as a practical matter only on an either/or basis. In most cases either a particular organization qualified for exemption or it did not. Either its letter of exemption would be revoked or it would remain in effect.

Initial implementaiton of the act posed several novel challenges for the Service. In response to the congressional concern whether private foundations would comply with the act, the then Commissioner, Randolph Thrower, committed the Service to identify the largest and most complex exempt organizations, including foundations, and examine them every 2 years and to examine all other foundations every 5 years.

Since the 1969 Reform Act the Service has devoted a significant part of its exempt organizations examination resources to private foundations. The foundation portion of the exempt organizations examination program can be divided into two broad stages: From January 1, 1970, to December 31, 1974, all private foundations were examined at least once; and since January 1975, the Service has examined each year between 4 and 10 percent of all foundations.

In addition, private foundations are included in the exempt organization phase of the taxpayer compliance measurement program. The largest and most complex private foundations have received special emphasis, first through the national office controlled case program, and since 1977 through the large case program.

Also, the Service included nonexempt charitable trusts subject to chapter 42 in the exempt organizations program in fiscal year 1976 and now examines 3 percent of these each year.

The first major challenge facing the Service in administering the 1969 act was the need for the first time to sort out and identify private foundations. In this regard the Service established a special form 4653 notification project that initially classified some 107,000 individually exempt and group-parent section 501(c)(3) organizations as public charities or private foundations.

It was very important for the organizations to know their status because of the immediate effect of the new rules. As the foundation regulations were promulgated the Service took a number of initiatives to provide guidance to the public. First it provided technical guidance to private foundations and to field personnel through publication of 167 revenue rulings and procedures covering 187 different issues.

The Service also publishes the Private Foundation Handbook and a comprehensive 38-page publication entitled "Tax Information for Private Foundations and Foundation Managers." This latter, publication 578, discusses in detail what we think is in rather plain language the requirements of the law and the foundation managers' responsibility.

Probably the most important and valuable reference provided for private and public foundations is the publication 78 which is the Cumulative List of Organizations. This is the official list of organizations to which contributions are deductible. It is the linchpin for notifying the public that an organization is a public charity, a private foundation or an operating foundation. The listing includes the organization's name, location, and of course the foundation's status designation. This publication is updated and the public can rely on the listing of the organization in making grants or contributions.

The major areas in which we have been requested to issue rules and to provide public guidance include exceptions in the self-dealing provisions, advance ruling on scholarship programs and set asides. I have included several examples of this type of ruling in our written statement.

When you asked for the IRS testimony you specifically requested we comment on the adequacy of the form 990-PF. The current 990-PF is what we think is a sound return, refined and develped with suggestions from the filers, from the users, and the public at large.

We have always given full consideration to the suggestions for form changes and we will continue to do so, but it is our intent to try to stabilize the current 990-PF and make revisions only for legislative changes or demonstrably important administrative or public information needs.

Adding new lines to a form increases the reporting burden for filers just as the form changes require additional information.

About 35 States and the District of Columbia require some annual financial report from charitable organizations under their jurisdiction. Prior to 1981 most of the States had their own form and there was no reciprocity among the States regarding the use of one State form to satisfy the reporting requirements of another State.

In 1981 the Service concluded a series of meetings by agreeing to make changes to the form 990 that those officials indicated were needed to make the IRS form more acceptable to the States as a uniform annual report. Form 990 is the form required to be filed with the IRS by public charities rather than private foundations. All but two of the States with reporting requirements for charities have now agreed to accept the form 990 for that purpose, and we are trying to convince the remaining two States to do so.

Many of these States also accept the form 990-PF in lieu of their own form for private foundations. These and other States that accept only the 990 will be represented on the form 990 advisory committee we have established.

This committee will consider all the substantive changes recommended and it will suggest changes of its own. This continued coordination with the States will insure that the Service will not unilaterally make form or instruction changes that eliminate information needed by the States and thereby make the form no longer acceptable to the States.

The Service, the States, and the filing organization benefit from this cooperative effort.

In 1969 to meet the needs for a more appropriate enforcement program we revitalized the exempt organization program and established a new branch in the National Office Audit Division. We had in place a technical branch. Most significantly, a key district concept was inaugurated to concentrate management of the field. Responsibility for issuing determinations on organizations exemption applications was centralized in key districts.

The single most significant organizational change affecting foundations occurred in 1974 when as a part of the Employee Retirement and Income Security Act the law established the Office of Assistant Commissioner for Employee Plans and Exempt Organizations. The office was charged with the responsibility and authority to direct the national and field activities relating to exempt organizations. This statute created for the first time a high level official in the Service whose principal function was to carry out a congressional policy to assure appropriate management of funds dedicated to charitable and other beneficial programs.

For the subcommittee's information, we have prepared several charts setting forth data about the universe of private foundations, their assets, revenues and disbursements, an account of public charities according to foundation status, and compilation of foundation excise tax collections.

Our exempt organization master file records indicate an increase of about 10,000 private foundations over the last 10 years from some 23,000 at the end of calendar 1972 to a little over 33,000 at the end of calendar 1982.

However, until 1975 when there were 28,000 private foundations the increase was mostly attributable to the classification of organizations whose determination of foundation status was suspended pending adoption of the final rules.

The fair market value of assets as reported on form 990-PF increased from $35 billion for 1976 to over $50 billion for return year 1981. The data from returns for years prior to 1976 is not reliable as that for 1976 and subsequent years because of the changes that occurred in our master file programing. Revenues of private foundations increased from $4 billion for the return year 1976 to $9 billion for 1981. Total expenses increased from $2.8 billion for return year 1976 to $4.8 billion for return year 1981.

Contributions, gifts and grants paid out increased from $1.9 billion for return year 1976, to over $3.6 billion for return year 1981.

Our accounting records indicate that during the fiscal year ending 1982, about $93 million was collected under provisions of section 4940, the 2-percent excise on investment income. Appendix 3 to our statement sets forth the excise tax collections from other code sections.

There are several unusual peaks in these figures. It seems they are attributable to occasional cases where a deficiency from a single case produces an extremely large tax liability. As is explained in the appendix 4, the annual costs of administering the employee plans program for 1982 are estimated to be about $84.5 million of which about $51 million is for the employee plans and exempt organizations programs and about $33.4 million for the exempt organization portion.

I would like to return to the subject of our audit activity and discuss the results of our compliance efforts. By the end of 1974 with the conclusion of the 5-year commitment to examine all the private foundations, the Service had audited about 28,000 entities. The examination results show the no-change rate for private foundations was 83 percent compared to 81 percent for all exempt organizations.

One hundred percent, 5-year coverage, was discontinued after the first period was completed. Our internal studies and evaluations concluded that even though the program was effective in making the foundation managers and grantors aware of the requirements of the 1969 act, blanket coverage was no longer needed for the smaller foundations. Further emphasis on private foundations diverted resources from other exempt organizations areas that needed audit attention.

In the report immediately following the 5-year program, the Service's exempt organizations examination program emphasized the TCMP and large private foundations. TCMP is designed to analyze examination data to allow measurement of compliance and help improve efficiency. The summary results of the TCMP survey indicate a high level of compliance with chapter 42 provisions and results indicated that if all private foundations had been examined, over 76 percent of the errors would have been in errors in the 4940 net investment income tax. Slightly more than 93 percent of the section 4940 errors would have been under $100. The study disclosed only 8 percent of the examinations would have resulted in the correction of the amount of sections 4941, 4942, 4943, 4944 and 4945 tax reported either because the amount was under-reported, or the act causing the liability was not reported.

Our experience with audits of foundations indicates a relatively high level of compliance with chapter 42 rules. From time to time our agents find it appropriate to assert tax deficiencies under chapter 42 which can be substantial, particularly if correction is at issue and the second level of taxes involved. In some cases, real abuses have occurred, and in others an honest dispute exists, such as in the connection with bona fide attempts to determine fair market value.

Having included examples in our written statement, I will not go into them.

With regard to the question of voluntary compliance, our data indicate in the 5-year period ending December 1982, about 85 percent of all returns on form 4720 were voluntarily filed by the foundations. Although we have no firm statistics, the judgment of our personnel is that most of these voluntarily filed 4720 forms report section 4942 tax in amounts usually below $5,000.

In closing, we want to emphasize our view that the 1969 legislation has been fair and effective. Although the initial implementation of the act was exceptionally challenging, we believe the law is relatively clear, fair, and straightforward to administer. By the development of the rulings and taxpayer education materials and audits, we attempt to administer the law fairly and evenly.

As you and your colleagues review the rules governing foundations we would like to leave you with our thought on what is at stake: The assurance that private foundations will continue to operate for public charitable purposes. Current law provides a delicate balance between effective regulation and the burdens which such regulation imposes on the foundations and their managers.

I am confident you will agree there is a continuing need for appropriate safeguards to maintain the impression of public trust and confidence that now seems to exist in foundations' affairs and the Service's ability to deal with any abuses that may arise.

Thank you, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF JAMES I. OWENS, ACTING COMMISSIONER OF INTERNAL REVENUE

Mr. Chairman and other Members of the Subcommittee, Good morning. I am James I. Owens, Acting Commissioner of Internal Revenue. Accompanying me today are S. Allen Winborne, Assistant Commissioner for Employee Plans and Exempt Organizations, and Howard M. Schoenfeld, Special Assistant for Exempt Organization Matters.

As many of you know already, Commissioner Egger is recuperating from surgery and is unable to appear before you today. He has asked me to convey to you his strong personal feelings on the constructive role periodic oversight hearings like this play in the overall improvement of tax administration. When the Congress takes the time and effort to review legislation that it had passed years earlier and then examines the actual operation of that law and its administration by the Executive Branch, that process of introspection is healthy and beneficial for government and its citizenry. It is for this reason that I most certainly welcome this opportunity to report on and discuss with you the Service's administration and enforcement of the rules governing private foundations which were enacted in the Tax Reform Act of 1969.

HISTORICAL BACKGROUND

The Congress first defined a private foundation in the Tax Reform Act of 1969 when it enacted an excise tax framework regulating foundations and the persons who control them. That legislation was truly unique in its approach, and it has since served as a model for three other tax acts: 1) in 1974, the ERISA prohibited transaction and other rules relating to qualified pension plans; 2) in 1976, the rules with respect to expenditures by public charities to influence legislation; and 3) in 1978, the provisions regarding Black Lung Benefit Trusts. However, Congressional interest in foundations began long before 1969.

Since 1915, when the Walsh Investigation studied the Rockefeller Foundation's business interests, charitable foundations—charitable organizations supported and controlled by individuals, families, or small groups rather than the general public—have been subject to Congressional and Treasury Department scrutiny. Two Congressional investigations, one held in 1947–48 by the House Ways and Means Committee, and one begun in 1962 by Rep. Wright Patman's subcommittee of the House Select Committee on Small Business, led to major legislation affecting private foundations.

The first major foundation legislation, part of the Revenue Act of 1950, sought to restrict both accumulation of income by foundations and self-dealing by those who controlled them. However, as pointed out in the 1965 Treasury Department Report on Private Foundations, the restrictions were not effective because the only penalty for noncompliance, revocation of exemption, was too harsh and thus difficult to enforce.

The second piece of major foundation legislation, part of the Tax Reform Act of 1969, grew out of the Patman subcommittee investigation and the 1965 Treasury Department Report. The Patman subcommittee focused on specific instances of foundation behavior and published an eight volume report entitled "Tax-Exempt Foundations and Charitable Trusts: Their Impact on Our Economy," which described a number of specific abuses.

The Treasury Department study sought to identify recurring problems and ways to correct them. It acknowledged that most foundations operated for philanthropic purposes and, as a whole, performed an important service to society. However, the study did find abuse by some foundations and the report identified six major problems: self-dealing between foundations and their donors; delay in benefit to charity because of unproductive investments or accumulated income; foundation involvement in businesses; use of foundations to control corporate and other property; financial transactions unrelated to charitable functions (e.g., borrowing for investment, unsecured loans, and speculative investments); and lack of public participation in foundation management. The Report recommended that these abuses be curbed by penalties on specific acts rather than loss of exemption.

TAX REFORM ACT OF 1969

In early 1969, the Treasury Department recommended private foundation reform legislation. Specifically, it recommended that self-dealing between a foundation and related parties be prohibited; that minimum general pay-outs be required; that foundation business holdings be limited; that foundations be prohibited from engaging in certain political activities, and that foundations be required to make information about grants to individuals available to the public. These proposals were enacted, with some modifications.

As reported in the explanation of the 1969 Act by the Staff of the Joint Committee on Internal Revenue Taxation. "In general, the Congress' decisions reflect the concept that private foundations are stewards of public trusts and their assets are no longer in the same status as the assets of individuals who may dispose of their own money in any lawful way they see fit". These reforms reflected an effort to preserve the basic tax exempt privileges that foundations enjoyed while controlling the use of tax exempt funds. The policy of the tax Reform Act was to maximize the public benefit from charitable contributions and to eliminate, by strict sanctions, foundation activities that derogate from that public purpose. The most significant changes were the imposition of tiered excise taxes of varying degrees of severity on both the foundations and those who control their activities, public reporting of foundation finances and activities, and a rebuttable presumption of private foundation status.

The new provisions are contained primarily in Chapter 42 of the Code, sections 4940 through 4948, and apply to organizations that do not meet the Act's requirements for being "publicly supported." The Act's definition of "publicly supported" was derived from the definition in the 1950 Act. Chapter 42 also applies to nonexempt charitable trusts that are not publicly supported. Chapter 42's provisions may be summarized as follows:

Section 4940 originally imposed a four percent tax on the net investment income of private foundations. Section 4948 imposed a similar tax on the gross investment income of foreign foundations. These taxes were intended to be an "audit fee" to reimburse the Treasury for the cost of administering the tax exemption provisions. The section 4940 tax was reduced to two percent for tax years beginning after September 30, 1977.

Section 4941 prohibits certain acts of self-dealing between private foundations and disqualified persons. An excise tax is imposed on the self-dealer and on any foundation manager knowingly participating in the act. This approach penalizes the wrong-doer rather than depleting the foundation's resources.

Section 4942 requires non-operating foundations to pay out a certain amount of their adjusted net income for charitable purposes. The statutory minimum payout requirement has been changed twice, in 1975 and 1981, and is now five percent of the value of investment assets. An excise tax is imposed on the foundation for failure to distribute the required amount.

Section 4943 limits foundation ownership of business enterprises. Generally, the total ownership by a foundation and its disqualified persons is limited to 20 percent (or in some situations up to 35 percent) of the voting stock of a corporation. Limits of up to 35 percent in combination with disqualified persons were placed on existing holdings and generous transitional rules (up to 35 years) were provided for the orderly disposition of existing excess holdings. An excise tax is imposed on the foundation if it fails to dispose of its excess business holdings.

Section 4944 prohibits foundations from making investments that might jeopardize their charitable purposes. An excise tax is imposed on the foundation and foundation managers who knowingly participate.

Section 4945 prohibits expenditures for non-charitable purposes. It also restricts lobbying and political activities, including some voter registration activities, and requires foundations to monitor carefully and account for grants made to individuals and to donees that are not public charities. An excise tax is imposed on the foundation and on any foundation managers that knowingly participate in the acts or failures to act.

Sections 4941-4945 all impose a higher second level tax if the prohibited acts are not corrected within specified periods of time.

A MAJOR CHALLENGE TO TAX ADMINISTRATION

The Tax Reform Act of 1969 created shock waves in the philanthropic community. Early commentators on the private foundation provisions suggested that the rules were so complex, punitive, and burdensome that most foundations would terminate and few new ones would be created. One writer called the Tax Reform Act of 1969 a "death blow" to foundations; another called the Act a calculated attempt to drive foundations out of business through the almost insuperable difficulty of ascertaining what the law means; and, yet another, echoing the same charge, called for its repeal. Administratively, some questioned the ability of the Service to interpret and enforce legislation so complex and cumbersome, and others were concerned that the law represented an invitation to onerous Federal and state regulations.

Both the Treasury and the Service were well aware of these charges and fears. It is our considered judgment that time and experience have proven them groundless. We believe that the 1969 Tax Reform Act has proven itself to be fair and effective, accomplishing much of the purpose Congress had in mind when enacting it, without stifling or inhibiting private philanthropy from advancing the fundamental causes for which it exists.

THE TREASURY AND IRS RESPONSE TO THE TAX REFORM ACT OF 1969

There are three major factors that I can point to as being responsible for the general success of the 1969 legislation. They are: The foundation regulations promulgated by the Treasury Deparrment under chapter 42 and related provisions. The Service's rulings program and taxpayer education efforts, and The Service's audit activities in the foundation area.

I shall cover each of these separately.

THE FOUNDATION REGULATIONS

These regulations reflect a clear and deliberate policy to give foundations basic freedom and flexibility to operate and fulfill their traditional philanthropic goals and missions. To be sure, many changes were required and all foundations had to find new ways of doing business, but the regulations sharpened the focus of the punitive aspects of chapter 42 to actual and potential wrongdoers. The regulations attempted to strike an appropriate balance between accommodating legitimate foundation concerns and protecting against potential abuses.

The drafters of the regulations, aware of the shock waves felt by the enactment of the law, made certain to provide flexible and reasonable transitional rules allowing foundations and their managers and contributors an opportunity to become acclimated to an entirely new way of life under the tax law. The Service is satisfied that the regulations appropriately embody the Act's in terrorem effect, preserving the tension created in the legislation between permitted areas of charitable ventures and the proscribed areas of conduct and creating strong incentives for self-regulation.

EXAMINATION ACTIVITY

As envisioned by the Congress and consistent with the concept of stewardship of charitable assets, effective enforcement of the chapter 42 provisions is not measured by the amount of tax dollars assessed against and collected from private foundations. Indeed, the most punitive of the penalty provisions is abated where it is shown that the assets of an involuntarily terminated private foundation will be used for charitable purposes. Appropriate correction and the preservation of assets for charitable uses are the ultimate goals set by Congress in enacting these provisions.

Prior to the Tax Reform Act of 1969, the Internal Revenue Code provisions dealing with exempt organizations could be administered, as a practical matter, only on an "either . . . or" basis. In most cases, either a particular organization qualified for exemption, or it did not; either its letter of exemption would be revoked, or it would remain in effect.

Initial implementation of the Act posed novel challenges for the Service. In response to Congressional concern whether private foundations would comply with the 1969 Tax Reform Act, the then Commissioner, Randolph Thrower, committed the Service to identify the largest and most complex exempt organizations, including foundations, and examine them every two years, and examine all other private foundations every five years.

Since the 1969 Tax Reform Act, the Service has devoted a significant part of its exempt organizations examination resources to private foundations. The foundation portion of the exempt organizations examination program can be divided into two broad stages: from January 1, 1970, to December 31, 1974, all private foundations were examined at least once; and since January 1, 1975, the Service has examined between four and ten percent of all private foundations each year.

In addition, private foundations are included in the Exempt Organizations Phase of the Taxpayer Compliance Measurement Program (TCMP). The largest and most complex private foundations have received special emphasis, first through the National Office Controlled Case (NOCC) Program and, since Fiscal Year 1977, through the Large Case Program. Also the Service included Non-Exempt Charitable Trusts (NECTs) subject to chapter 42 in the Exempt Organizations Program in Fiscal Year 1976 and now examines three percent of NECTs each year.

As I shall discuss later in greater detail, the available examination results indicate a relatively high degree of compliance by private foundations with the provisions of chapter 42.

RULINGS ACTIVITY AND TAXPAYER EDUCATION

The first major challenge facing the Service in administering the 1969 Reform Act was the need, for the first time, to sort out and identify all private foundations. In this regard, the Service established a special "Form 4653" notification project that initially classified sone 107,000 "individually exempt" and "group-parent" section 501(c)(3) organizations as either public charities or private foundations. It was critically important for organizations to know their status because of the immediate effects of the new rules. By the end of 1970, over 60 percent of this classification effort was completed, and the remaining section 501(c)(3) organizations could rely on their own determination of their status, at least on a temporary basis until final regulations were issued.

Through its letter rulings program, the Service issued hundreds of private rulings with the concurrence of the Office of Tax Legislative Counsel that gave assurance to organizations regarding proposed transactions when they attempted to comply with the statutory requirements. In addition, the Service readily responded to organizations seeking clarification and assistance regarding the interpretation of the new law.

As the foundation regulations were promulgated, the Service took a number of initiatives to provide guidance and information to the public. First, it provided technical guidance to private foundations and field personnel through the publication of the 167 revenue rulings and procedures covering 187 different issues. The Service also publishes a Private Foundations Handbook and a comprehensive 38-page publication called Tax Information for Private Foundations and Foundation Managers. This latter item, Publication 578, discusses in detail, but in plain language, the requirements of the law and foundation managers' responsibilities.

Probably the most important and valuable reference provided by the Service for private foundations and the public in their daily operations is Publication 78, Cumulative List of Organizations. This is the official list of organizations to which contributions are deductible. It is the linchpin for notifying the public that an organization is a public charity, a private foundation, or an operating foundation. This listing includes the organization's name, location, and of course, foundation status designation. This publication is periodically up-dated and the public can rely on the listing of an organization in making grants or contributions.

TECHNICAL RULINGS

The major areas in which we have been requested to issue rulings and provide public guidance include exceptions ot the self-dealing provisions, advance rulings on scholarship program, and set-asides. (See Appendix VII).

The following are examples of typical situations on which the Service has been requested to rule:

(1) Foundation X held 100 percent of the stock of A Corporation on May 26, 1969. In order to dispose of its excess business holdings, X, in 1974, decides to sell stock in A to M, a disqualified person. X requests a ruling from the Service that the sale meets the requirements of section 101(l)(2)(B) of the Tax Reform Act of 1969. In this situation, the Service is able to give X a ruling that, as long as the stock is sold for fair market value, the sale to M is not an act of self-dealing under section 4941, and X is able to dispose of its holdings without being subject to tax under section 4943. Section 101(l)(2)(B) of the Tax Reform Act of 1969 permits the sale of excess business holdings to disqualified persons if the stock is held at the time of the adoption of the Act. But for the rules in section 101(l)(2)(B) of the Act (part of the "Savings Provisions"), these sales would be acts of self-dealing under section 4941 by the disqualified persons.

(2) Y, a private foundation, proposes to award scholarship grants to children of employees of the B Company. Y was created by the founder of B, and Y's trustees are appointed by B. The issue involved in awarding the grants is whether a grant will be continued should the parent of a child receiving the scholarshp leave the company. If the grant will be continued the Service will issue Y a ruling that the program is not compensatory and will not give rise to a taxable expenditure under section 4945. Section 4945(g) requires a foundation to obtain an advance ruling from the Service if the foundation is awarding scholarship or fellowship grants. There are a number of issues involved in the treatment of scholarship and fellowship grants including whether the grant procedures ensure that grants are awarded on a nondiscriminatory basis. Also, the grants awarded must not be compensatory under the rules of section 117.

(3) Z, a private foundation, proposes to build a museum to house paintings left to it by its founder. To do so, it must expend funds over a five-year period in such a way as to meet its commitments on the project. These expenditures do not necessarily coincide with the foundation's annual need to distribute income to avoid tax under section 4942. Z may create a set-aside for this project if it obtains a ruling in advance from the Service. Foundations that wish to set-aside assets for specific projects and have the set-aside treated as a qualifying distribution under IRC 4942(g) ordinarily must obtain an advance ruling from the Service holding that the set-aside is necessary to the accomplishment of the project. Unless the foundation obtains this ruling, the set-aside will not be treated as a qualifying distribution for section 4942 purposes and the foundation might be subject to tax for failing to distribute enough of its income. In this kind of situation, the Service has ruled that the set-aside is necessary to the accomplsihment of the foundation's project.

ADEQUACY OF FORM 990–PF

When you asked for IRS testimony, you specifically requested we comment on the adequacy of the Form 990–PF, and we welcome this chance to apprise the Congress again about our efforts in this regard. On May 11, 1983, the Commerce, Consumer and Monetary Affairs Subcommittee of the House Committee on Government Operations held a hearing to determine the extent to which private foundations provide the financial and other information required to be reported on the annual return, Form 990–PF, that must be filed by all private foundations, both taxable and exempt. The hearing also dealt with the question of whether the Service was adequately securing compliance with the reporting requirements when a foundation failed to comply fully on its own.

The Subcommittee heard testimony from representatives of the General Accounting Office the Council on Foundations, the National Committee for Responsive Philanthropy, and the Foundation Center (the latter two are organizations that utilize the information reported on foundation returns), and finally from the Internal Revenue Service. At that hearing, the General Accounting Office submitted a draft report of a study it had conducted at the request of the Subcommittee. The study focused on whether the public's information needs are met by the data furnished by foundations on their annual returns. Although the study found that foundations did not always provide all the information specifically required by the Code, by the regulations, or by Form 990–PF itself, it was significant that GAO did not recommend any changes to Form 990-PF or instructions, but only greater efforts by the Service to secure unreported information that is already required.

Representatives of the foundations and the users of Form 990-PF data who spoke at the May 11th hearing mentioned a need for some minor changes to the instructions and even a few specific changes to require additional information. The current Form 990-PF is a basically sound return which has been refined and developed with suggestions from filers, users, and the public at large. We have always given full consideration to each suggestion for form changes that we receive and we will continue to do so, but it is our intent to stabilize the current Form 990-PF and make revisions only for legislative changes or demonstrably important administrative or public information needs. Adding new items to a form increases the reporting burden for filers, just as form changes that require no additional information do.

Besides being a public information document, Form 990-PF is an important tool in the Service's administration of the tax exemption and chapter 42 provisions. We believe that it serves those purposes very well. It is used to compute and report the section 4940 tax on investment income and to disclose current year violations of chapter 42 and uncorrected violations of prior years. The form shares similar characteristics with several forms filed by employee benefit plans subject to chapter 43 restrictions in that the foundation's return commences the running of the period of limitations on assessment of any chapter 42 tax (or chapter 43 tax in the case of employee plans) arising from a transaction occuring in the period covered by the return. This is true whether the party liable for the tax is the foundation that files the form or any foundation manager or other disqualified person who participated in a chapter 42 violation. This puts the burden on the Service to detect chapter 42 violations promptly, to ensure that appropriate correction of the violation is made, and to determine the amount of tax and penalties due. This also affords a measure of protection to the party or parties involved because it adds finality to what might otherwise be an open-ended taxable period going back many years with resulting taxes, penalties, and interest that could be greatly out of proportion to the amount involved in the violation.

COORDINATION WITH STATE OFFICIALS

Approximately 35 states and the District of Columbia require some type of annual financial report from charitable organizations under their jurisdiction. Prior to 1981 most of these states had their own unique reporting form and there was little reciprocity among the states regarding the use of one state form to satisfy the reporting requirement of another state. In 1981 the Service concluded a series of meetings with state charity officials by agreeing to make changes to IRS Form 990 that those officials indicated were needed to make the IRS form acceptable to the states as a uniform annual report. Form 990 is the form required to be filed with IRS by public charities rather than private foundations. All but two of the states with reporting requirements for charities have now agreed to accept Form 990 for that purpose, and we are trying to convince the remaining two states to do so.

Many of these states accept Form 990-PF in lieu of their own form from private foundations. These and the other states that accept only Form 990 will be represented on a Form 990 Advisory Committee. The Service has received approval to establish that Committee from Treasury and the Office of Management and Budget. The Committee will also include representatives of public charities, private foundations, and other interested members of the public. The Committee will consider all substantive changes proposed to Forms 990 and 990-PF and the instructions to those forms, and it will suggest changes of its own. This continuing coordination with the states will ensure that the Service will not unilaterally make any form or instruction changes that would eliminate information needed by the states and thereby make the form no longer acceptable to them. The Service, the states, and the filing organizations in particular all benefit from this cooperative effort.

ORGANIZATIONAL, MANAGEMENT AND OTHER CONSIDERATIONS

In 1969, to meet the need for a more adequate enforcement program, the Service revitalized its exempt organization examination program and established a new branch in the National Office Audit Division. The Service had in place an Exempt Organizations Technical Branch whose primary function was, and is, to answer the substantive questions forwarded to the National Office for rulings and technical advice. Most significantly, a "key district" concept was inaugurated to concentrate the management of field activities and the expertise of its field personnel. Responsibility for issuing determinations on exemption applications and conducting exempt organization examinations was centralized in the key districts.

The single most significant organizational change affecting foundations occurred in 1974 when, as part of the Employee Retirement Income Security Act, the law established the Office of the Assistant Commissioner for Employee Plans and Exempt Organizations. The new Assistant Commissioner's office was charged with the responsibility and authority to direct National and field activities relating to exempt organizations. This statute created for the first time a high level official in the Service whose principal function was carrying out a Congressional policy to assure the appropriate management of funds dedicated to charitable and other beneficial purposes.

At approximately the same time, the Commission on Private Philanthropy and Public Needs (The Filer Commission) analyzed Service administration of the laws relating to charitable organizations and said the structure of the reorganization provided the Service with a special opportunity to improve procedures dealing with charitable organizations and to remedy existing administrative problems.

This year, the Service has made further refinements in its administration through the further consolidation of key districts. We think those changes when fully implemented will improve our administration of this highly sensitive area.

Experience with the Tax Reform Act by the Service and the public has led to several significant amendments to the Act which have been beneficial in our day to day administration:

The enactment in 1980 of sections 4961 and 4962, curing a critical flaw in the way second-level foundation excise taxes were imposed under the Code as originally enacted,

The streamlining in 1980 of private foundation reporting requirements, and

The provision in 1976 of declaratory judgment procedures regarding determinations of initial and continuing qualification as to exemption and foundation status, and eligibility for deductible contributions.

IRS FINANCIAL AND STATISTICAL DATA

For the Subcommittee's information, we have prepared several charts setting forth relevant data about the universe of private foundations; their assets, revenues, and disbursements; a count of public charities according to the type of their foundation status; and a compilation of foundation excise tax collections.

Our Exempt Organization Master File records indicate an increase of approximately 10,000 private foundations over the last ten years from 23,172 at the end of calendar year 1972 to 33,308 at the end of calendar year 1982. (See Appendix I) However, until approximately 1975, when there were 28,407 private foundations, the increase was mostly attributable to the classification of organizations whose determination of foundation status was suspended pending adoption of the final foundation classification regulations.

The fair market value of assets as reported on Form 990-PF increased from $35.3 billion for return year 1976 to $50.9 billion for return year 1981. (See Appendix II-A) The data from returns for years prior to 1976 is not as reliable as that for 1976 and subsequent years because of master file programming changes, changes in return processing procedures, and for years before 1974, the absence of final private foundation classification regulations.

Revenues of private foundations increased from $4 billion for return year 1976 to $9 billion for return year 1981. Total expenses increased from $2.8 billion for return year 1976 to $4.8 billion for return year 1981. Contributions, gifts, and grants paid out increased from $1.9 billion for return year 1976 to $3.6 billion for return year 1981.

The data on foundations that has just been cited are all from the Master File Records System. However, the Service has an alternative source for data on foundations from Statistics of Income studies. These studies, which were conducted for foundations for 1974 and 1979, are based on samples of foundations tax returns. The samples are scientifically designed to minimize error due to sampling, and all of the data from the returns selected is thoroughly tested for accuracy and consistency. Because the procedure for collecting this data differs from the Master File System, some differences exist. We refer the Subcommittee to those studies for a more detailed and comprehensive analysis of the financial information reflected on foundation returns. See Appendix II-C for an extract of relevant data from the 1979 returns.

Our accounting records indicate that during the fiscal year ending in 1982, approximately $93 million was collected under the provisions of section 4940, the 2 percent excise tax on net investment income. In Appendix III, attached, we have set forth the excise tax collections from the other Code sections as well. There are several unusual peaks in these figures, and it seems they are directly attributable to occasional instances where the asserted deficiency from a single case produces an extremely large tax liability.

As explained more fully in the Appendix IV, the annual costs of administering the employee plans and exempt organizations programs for FY 1982 are estimated to be approximately $84.5 million, of which about $51.1 million is for the employee plans program and about $33.4 million for the exempt organizations portion.

RESULTS OF COMPLIANCE EFFORTS

By the end of 1974, with the conclusion of the five year commitment to examine all private foundations. The Service had audited approximately 28,000 entities. The available examination results show the no-change rate for private foundations was 83 percent, compared to 81 percent for all exempt organizations.

The 100 percent, five-year coverage was discontinued after the first period was completed. Our internal studies and evaluations concluded that, even though the program was effective in making foundation managers and grantors aware of the requirements of the 1969 Tax Reform Act, blanket coverage was not needed, especially for small foundations. Further, emphasis on private foundations diverted resources from other exempt organization areas that needed audit attention. Thus, since completion of the five-year commitment, the Service has emphasized selection of the returns most in need of examination.

In the period immediately following the five-year program, the Service's exempt organizations examination program emphasized TCMP and large private foundations. TCMP is designed to analyze examination data, to allow measurement of compliance, and to help improve the efficiency and effectiveness of operations. The program employs random selection of exempt organization returns to insure equal likelihood of all organizations being examined.

The summary results of the TCMP private foundation survey indicated a high level of compliance with the provisions of chapter 42. The results indicate that if all private foundations had been examined, over 76 percent of the errors would have been in the reporting of the section 4940 tax. Furthermore, slightly more than 93 percent of those section 4940 errors would have been under $100. The study disclosed that only eight percent of private foundation examinations would have resulted in correction of the amount of section 4941, 4942, 4943, 4944, or 4945 tax reported, either because the amount was unreported or the act causing the tax liability was not reported.

As reflected in Appendix IX, IRS experience with audits of foundations indicates a relatively high level of compliance with the chapter 42 rules. From time to time, our agents will find it appropriate to assert tax deficiencies under chapter 42, which can be substantial in amount particularly if "correction" is at issue and the second-level tax is involved. In some of these cases, real abuses have occurred; in others, an honest dispute exists, such as in connection with bonafide attempts to determine fair market value.

The following are examples of audit situations where a chapter 42 tax has been asserted:

A foundation purchased stock in a corporation with close ties to a foundation manager who was also the foundation's only substantial contributor. The stock purchased was part of a public offering. The prospectus for this offering clearly disclosed that the stock issue was highly speculative. In the same year, the foundation made speculative investments in two other small corporations and a partnership. The same foundation manager held a minority interest in all of these entities. The aggregate amount that the foundation risked in making these investments was substantial in absolute terms and in relation to the foundation's total assets. Section 4944 taxes were imposed against the foundation as a result of these investments because they jeopardized the foundation's ability to carry out its charitable purposes. Taxes under section 4944 were also imposed against the responsible managers.

The managers of a small foundation maintained one checking account that commingled the funds of the foundation and his own private business. When the business funds in the account were entirely depleted, he sometimes continued to issue checks for business expenses, in effect borrowing foundation funds that he later repaid by making a business deposit to the account. The foundation and the business also shared the same office. Although the foundation made only a few grants each year and utilized very little or the office space for its records, the foundation manager paid most of the office rent and utilities with the foundation's funds. Using foundation funds for the improper benefit of a disqualified person constituted self-dealing by the foundation manager. Also, because the foundation's funds were spent for noncharitable purposes, each such expenditure was a taxable expenditure under section 4945.

A private foundation purchased stock from a number of related disqualified persons, giving each of them cash and interest-bearing notes in return for the securities. Each purchase, therefore, constituted a double violation of the section 4941 proscription against self-dealing—a purchase from a disqualified person and borrowing from a disqualified person.

One of the trustees of a large grant-making foundation had an accident that left him permanently and totally disabled. A court named one of his relatives as conservator of his assets. In spite of the fact that the trustee ceased performing all of the duties required of him as a foundation trustee, for two years he continued to receive the same amount of trustee fees he had been receiving prior to the accident. Section 4941 permits reasonable compensation to be paid trustees and other foundation managers but treats as self-dealing any payment of excessive compensation. In this case, the compensation paid the disabled trustee was excessive because neither he nor his conservator rendered any service at all to the foundation. The excess compensation payments were also taxable expenditures by the foundation since they did not further any charitable or investment purpose of the foundation. The fees were discontinued only as a result of an IRS examination of the foundation.

A private foundation owned certain paintings. The foundation permitted a substantial contributor, who was a disqualified person, to place the paintings in his home. The loan of such paintings constituted an act of self-dealing.

A foundation manager representing himself and the foundation willfuly and without reasonable cause sells property he owns to the foundation knowing that the sale is an act of self-dealing. The manager is liable for both the tax imposed on the act of self-dealing under 4941(a)(1) and as a foundation manager under section 4941(a)(2).

With regard to the question of voluntary compliance by foundations, our data indicate that during the five-year period ending in December 1982, approximately 85% of all returns on Form 4720 were voluntarily filed by foundations. Although we have no firm statistics, the judgment of our experienced personnel working in this area is that most of these voluntarily filed Forms 4720 report section 2942 tax in amounts usually below $5,000.

ADMINISTRATIVE BENEFIT OF FOUNDATION RULES

Far from being too harsh or burdensome, we believe the private foundation tax rules are actually beneficial to the charities that are governed by those restrictions. Absent the foundation excise tax rules, the only sanction available to the Service in the case of abuse or misconduct is revocation of the foundation's tax-exempt status.

As we still see in the area of public charities, that sanction can sometimes prove to be unduly harsh and difficult to administer. For example, a hospital or university that is providing a community benefit, but is being financially abused by those who control it, would lose its tax-exempt status. In such an instance, the public and charity suffer, but the wrongdoers go unpunished. Others, including the Filer Commission, have also recognized this anomalous result. By contrast, the private foundation provisions provide sanctions only against the abusers while assuring the permanent dedication of assets for charitable uses.

SUMMARY

In closing, we want to emphasize our view that the 1969 legislation has been fair and effective. Although the initial implementation of the Act was exceptionally challenging, we believe that this law is now relatively clear, fair, and straightforward to administer. Through the development of rulings, taxpayer education materials, and our audit presence, we attempt to administer the law fairly and evenly.

As you and your colleagues review the rules governing foundations, we'd like to leave you with our thought on what is at stake—the assurance that private foundations will continue to operate for public, charitable purposes. Current law provides a delicate balance between effective regulation and the burdens such regulation imposes on foundations and their managers. I am confident you will agree there is a continuing need for appropriate safeguards to maintain the impression of public trust and confidence that now seems to exist in foundation affairs and in the Service's ability to deal with any abuses that may arise.

My associates and I will now attempt to answer any questions you may have.

APPENDIX

Number	Title
I.	Private Foundations and Active Section 501(c)(3) Organizations
IIA.	Form 990-PF Financial Data
IIB.	1982 Form 990-PF Indicating Line Items on Appendix IIA.
IIC.	Extract from SOI Study of 1979 Returns Balance Sheet and Income Statements
III.	Private Foundation Excise Tax Collections
IV.	Estimated Costs to Administer EP and EO Programs
V.	Public Charities by Category
VI.	Private Foundation Issues in Revenue Rulings & Procedures 1970 to Present
VII.	Private Letter Rulings on Private Foundation Issues 1977-1982
VIII.	Exempt Organizations Examination Coverage as a Percentage of Entities
IX.	Private Foundation No Change Rate for Chapter 42 Tax Changes

APPENDIX I

PRIVATE FOUNDATIONS AND ACTIVE SECTION 501(c)(3) ORGANIZATIONS

As of Dec. 31	Private Foundations	Sec. 501(c)(3) Organizations* (Including Private Foundations) (Rounded to Nearest Hundred)
1982	33,308	300,800
1981	31,866	297,800
1980	32,618	305,900
1979	31,824	292,500
1978	31,319	281,200
1977	30,149	269,200
1976	28,821	252,200
1975	28,407	231,300
1974	28,243	219,700
1973	25,703	224,800
1972	23,172	207,800
1971	Not available	Not Available
1970	Not available	Not Available
1969	Not available	Not Available

*These figures do not represent a true universe of section 501(c)(3) organizations because certain organizations such as churches, their integrated auxiliaries, and conventions or associations of churches need not apply for recognition of exemption unless they desire to receive a ruling. When issued, the ruling letter goes to the central organization but it covers all of its subordinate units. Only the central organization is established on the exempt organizations masterfile where it is counted as one entity in the figure as stated above. However, this one ruling may represent a large number (tens of thousands) of subordinate units, as in the case of larger religious groups. An exception is subordinate units considered nonintegrated auxiliaries, which are established and included in the above figures since they may be required to file information returns as prescribed under section 6033.

SOURCE: EO Masterfile Tables

APPENDIX II-A

FORM 990-PF FINANCIAL DATA
(in billions of dollars)

Return Year**	Col.(a)* Fair Market Value of Assets	Col.(b)* Revenue	Col.(c)* Expenses & Disbursements	Col.(d)* Contributions, Etc. Paid ***
1981	$51.0	$9.0	$4.8	$3.7
1980	48.0	7.3	4.0	3.1
1979	37.6	5.5	3.1	2.4
1978	34.6	4.4	2.9	2.0
1977	36.4	4.5	2.8	2.0
1976	35.3	4.1	2.8	2.0

*These columns correspond to the following line items on the 1982 Form 990-PF, or equivalent items on prior years' returns: Col.(a) - in header; Col.(b) - line 13, Col. A; Col.(c) - line 24, Col. A; Col.(d) - line 23, Col A. See Appendix II-B.

**A return year consists of all returns filed and posted (over a two-year period) for a given year and whose annual accounting period ends in that year.

***Included in Expenses and Disbursements.

SOURCE: EO Masterfile Tables

NOTE: See IRS SOI studies of 1974 and 1979 returns for a more detailed and comprehensive analysis of private foundations' financial return information. (Pub. 1136 (10-82) SOI Bulletin, Fall 1982; and Pub 1073 (4-81) SOI 1974-1978, Private Foundations).

APPENDIX II B

Form **990-PF**
Department of the Treasury
Internal Revenue Service

Return of Private Foundation

or Section 4947(a)(1) Trust Treated as a Private Foundation
Note: You may be able to use a copy of this return to satisfy State reporting requirements.

OMB No. 1545-0052

1982

For the calendar year 1982, or tax year beginning , 1982, and ending , 19

Please type, print, or attach label. See Specific Instructions.

Name of organization
Address (number and street)
City or town, State, and ZIP code

Employer identification number
State registration number (see instructions)
If the foundation is in a 60-month termination under section 507(b)(1)(B) check here . ▶ ☐
Fair market value of assets at end of year COL. (e)

If address changed, check here ▶ ☐ Foreign organizations, check here ▶ ☐

Check type of organization
☐ Exempt private foundation ☐ 4947(a)(1) trust ☐ Other taxable private foundation
Check this box if your private foundation status terminated under section 507(b)(1)(A) ▶ ☐

Section 4947(a)(1) trusts filing this form in lieu of Form 1041, check here and see general instructions . . . . ▶ ☐

The books are in care of ▶ ....
Located at ▶ Telephone no. ▶

Part I Analysis of Revenue and Expenses (See instructions for Part I)

		(A) Revenue and expenses per books	(B) Computation of net investment income	(C) Computation of adjusted net income	(D) Disbursements for charitable purpose
Revenue	1 Contributions, gifts, grants, etc. (attach schedule)		▨	▨	▨
	2 Contributions from split-interest trusts . . .	▨		▨	▨
	3 Membership dues and assessments		▨	▨	▨
	4 Interest on savings and temporary cash investments . .				▨
	5 Dividends and interest from securities				▨
	6 Gross rents				▨
	7 Net gain or (loss) from sale of assets not on line 11 . .		▨	▨	▨
	8 Capital gain net income	▨		▨	▨
	9 Net short-term capital gain	▨	▨		▨
	10 Income modifications	▨	▨		▨
	11 Gross profit from any business activities: (Gross receipts ▶ $.................... minus cost of sales ▶ $..........................)		▨		▨
	12 Other income (attach schedule)				▨
	13 Total—add lines 1 through 12	COL (B)			▨
Expenses	14 Compensation of officers, etc.				
	15 Other salaries and wages				
	16 Pension plans, employee benefits				
	17 Investment, legal, and other professional services				
	18 Interest				
	19 Taxes (attach schedule)				▨
	20 Depreciation and depletion				
	21 Occupancy				
	22 Other expenses (attach schedule)				
	23 Contributions, gifts, grants (from Part XIII) . .	COL (d)	▨	▨	
	24 Total—add lines 14 through 23	COL (c)			
25	(a) Excess of revenue over expenses: Line 13 minus line 24 . .		▨	▨	▨
	(b) Net investment income (if negative, enter -0-) . .	▨		▨	▨
	(c) Adjusted net income (if negative, enter -0-)	▨	▨		▨

Part II Excise Tax On Investment Income (Section 4940(a), 4940(b), or 4948—See Instructions)

1 Domestic organizations enter 2% of line 25(b). Exempt foreign organizations enter 4% of line 25(b) . . . . ________
2 Tax under section 511 (exempt foundations and exempt foreign organizations enter -0-) . . . . ________
3 Add lines 1 and 2 . . . .
4 Tax under subtitle A (exempt foundations and exempt foreign organizations enter -0-) . . . . ________
5 Tax on investment income (line 3 minus line 4 (but not less than -0-)) . . . .
6 Credits: (a) Exempt foreign organizations—tax withheld at source . . . . ________
(b) Tax paid with application for extension of time to file (Form 2758) . . . . . ________
7 Tax due (line 5 minus line 6) . Pay in full with return. Make check or money order payable to Internal Revenue Service (Write employer identification number on check or money order) ▶ ....
8 Overpayment—(line 6 minus line 5) . . . .

For Paperwork Reduction Act Notice, see page 1 of the Instructions.

Table 4.—Balance Sheets and Income Statements, by Size of Total Fair Market Value of Assets

[All figures are estimates based on samples—money amounts are in thousands of dollars]

Item	Total	Size of total fair market value of assets: Assets zero or not reported	$1 under $25,000	$25,000 under $100,000	$100,000 under $500,000	$500,000 under $1,000,000	$1,000,000 under $10,000,000	$10,000,000 under $50,000,000	$50,000,000 or more
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Number of foundations	27,980	1,406	8,306	5,741	6,571	2,045	3,131	466	315
Total assets (book value)	34,898,831	89,024	108,864	341,506	1,672,738	1,320,832	8,204,413	8,334,804	14,824,861
Cash, total	2,011,306	6,160	32,429	91,568	250,627	177,170	656,729	356,689	430,917
Savings and interest-bearing accounts	1,431,234	4,169	20,836	69,864	169,819	135,632	514,557	265,562	221,756
Other	580,074	1,991	11,592	21,704	80,807	41,538	142,172	91,107	209,161
Accounts receivable, net	238,863	606	1,194	3,833	12,650	10,775	58,786	57,815	80,919
Notes receivable, net	523,186	151	1,226	6,104	31,665	29,630	163,156	157,791	133,467
Inventories	38,712	—	303	1,702	5,386	3,463	17,225	7,200	4,412
Investments in government obligations, total	4,152,801	6,848	4,080	28,786	187,354	160,781	1,070,966	1,203,849	1,482,125
United States and instrumentalities	4,086,661	6,744	3,808	25,395	183,968	156,465	1,037,951	1,183,820	1,478,490
State and local	66,240	108	282	1,391	3,385	4,315	33,016	20,128	3,635
Investments in corporate bonds	7,037,133	16,256	7,048	90,808	277,462	256,635	1,710,636	1,868,056	2,849,031
Investments in corporate stock	15,740,143	14,801	16,383	99,895	405,683	455,565	3,115,893	3,445,250	8,084,664
Mortgage loans	422,250	280	257	6,465	18,067	23,794	78,411	185,995	108,010
Other investments	2,239,432	3,871	5,368	29,332	145,047	103,110	534,432	499,667	918,315
Depreciable assets held for investment purposes	400,891	786	903	1,264	30,549	17,782	139,861	86,715	131,949
Less: Accumulated depreciation	177,298	724	3	263	8,202	6,579	50,478	35,388	85,456
Depreciable assets held for charitable purposes	567,656	4,303	1,733	8,070	43,900	34,531	240,306	127,326	107,887
Less: Accumulated depreciation	124,033	848	663	2,486	5,130	8,024	46,456	32,380	29,036
Land held for investment purposes	378,048	1,087	251	4,187	20,316	20,757	130,145	138,503	64,833
Land held for charitable purposes	182,084	1,867	256	2,207	21,826	15,457	82,357	36,549	21,786
Other assets	1,027,924	3,723	28,575	[illegible]	136,831	34,003	291,440	240,267	281,062
Total liabilities	1,691,443	1,228	35,866	[illegible]	31,228	32,613	286,182	423,238	863,784
Accounts payable	133,850	88	3,520	1,833	6,876	5,243	27,136	21,930	67,421
Contributions, gifts, and grants payable	648,917	230	1,124	786	3,450	6,882	75,279	219,466	341,498
Mortgages and notes payable	288,505	267	20,165	7,148	8,230	12,010	113,126	108,784	38,774
Other liabilities	220,171	642	2,076	2,696	12,669	8,278	64,481	73,058	56,091
Net worth	33,106,587	87,796	74,889	329,041	1,641,507	1,288,318	7,924,312	7,910,766	13,836,778
Total receipts	6,013,129	13,072	82,924	95,819	361,384	309,453	1,801,947	1,392,466	2,286,183
Contributions, gifts, and grants received	2,281,836	7,803	76,329	69,565	227,440	144,606	801,745	862,152	510,082
Gross dues and assessments	5,682	93	56	195	483	756	3,874	121	—
Interest	1,224,881	3,566	3,282	12,815	66,526	54,839	314,982	317,666	451,979
Dividends	1,198,303	1,700	2,956	7,201	38,424	35,015	233,766	244,581	632,660
Gross rents and royalties	196,619	932	1,562	584	7,435	7,324	60,532	57,866	60,351
Net gain (or loss) from sale of assets	757,611	-373	956	2,112	13,100	18,844	139,600	170,580	412,819
Gross profit from business activities	50,464	6	2,583	1,466	4,256	2,323	25,723	11,416	2,697
Other income	299,919	112	3,200	1,846	4,720	5,743	41,623	28,100	214,565
Total deductions	3,535,777	19,535	108,053	79,534	241,276	182,192	929,210	827,307	1,148,578
Contributions, gifts, and grants paid	2,801,000	15,662	74,694	58,948	182,817	144,762	715,062	662,318	945,914
Compensation of officers	71,805	377	2,865	2,086	4,720	3,518	10,536	17,314	21,357
Other salaries and wages	168,556	187	13,103	5,057	11,546	7,221	48,505	38,226	44,631
Pension plan contributions	14,005	—	—	96	266	157	2,469	4,246	6,733
Other employee benefits	16,106	2	1,310	330	677	186	2,476	2,316	8,803
Investment, legal, and other professional services	81,430	484	2,367	2,366	5,966	5,153	22,744	19,818	22,661
Interest	17,084	1	100	297	827	693	6,257	6,067	2,750
Taxes	88,655	216	1,036	821	4,065	3,465	20,969	22,155	36,834
Depreciation, amortization, and depletion	27,233	303	170	536	1,536	1,665	10,325	5,879	6,787
Rent	16,744	93	1,809	502	801	862	4,666	3,453	4,865
Other expenses	235,051	2,191	10,273	[illegible]	17,922	14,676	75,496	57,802	46,421
Net income (less deficit)	2,477,364	-6,463	-15,129	16,286	120,107	87,261	872,738	565,102	1,136,555
Net income	2,826,936	3,725	9,755	31,662	161,147	114,452	995,336	630,449	1,180,407
Deficit	349,562	9,266	24,884	15,377	41,040	27,191	122,603	65,347	43,852
Total assets (fair market value)	44,647,789	—	61,674	322,136	1,564,737	1,448,961	9,320,233	9,875,863	22,054,375
Information items:									
Beginning of year assets, total	31,678,973	66,645	146,784	321,670	1,536,864	1,255,132	7,480,782	7,619,677	13,239,420
Selected beginning of year assets:									
Inventories	32,296	—	322	1,433	4,297	2,806	10,256	8,804	4,386
Investments in corporate stock	16,981,350	18,156	21,387	97,355	2,530,126	450,853	3,035,727	3,343,101	7,484,642
Depreciable assets held for investment purposes	403,747	2,303	487	1,232	19,299	17,318	138,212	98,366	128,539
Less: Accumulated depreciation	168,856	1,517	1	193	7,826	6,647	55,225	34,320	63,126
Depreciable assets held for charitable purposes	507,051	2,887	1,294	6,743	39,845	29,626	210,018	118,507	97,320
Less: Accumulated depreciation	105,784	636	517	2,098	4,293	6,811	30,246	27,135	29,027

NOTE: Detail may not add to total because of rounding.

APPENDIX III

PRIVATE FOUNDATION EXCISE TAX COLLECTIONS
(IN THOUSANDS OF DOLLARS)

		IRC SECTIONS					
FY	4940	4941	4942	4943	4944	4945	TOTAL
1971	$24,589	$8	$ -	$27	$ -	$ 1	$24,625
1972	56,045	45	-	51	-	7	56,148
1973	76,617	78	94	13	16	1	76,819
1974	69,802	229	160	3	8	8	70,210
1975	63,828	324	360	6	-	1	64,519
1976	59,859	310	950	9	102	95	61,325
1977	78,592	212	809	3	-	103	79,719
1978	83,950	6,110*	1,265	-	2	79	91,406
1979	63,217	234	1,306	24	3	130	66,944
1980	65,280	239	976	67	2	117	66,681
1981	84,045	2,576**	1,158	44	4	150	87,976
1982	93,188	227	1,619	36	4	142	95,216

SOURCE: IRS NEWS RELEASES

* Includes tax payment in excess of $4.1 million in one case.

** Includes tax payment in excess of $2.0 million in one case.

Estimated Costs to Administer EP and EO Programs*
FY 1982
(in millions of dollars)

	E P	E O	Total
Direct	$43.3	$28.2	$71.5
Indirect**	7.8	5.2	13.0
Total	$51.1	$33.4	$84.5

* Only the direct total costs are tracked by the Service's administrative accounting system; the allocations between EP and EO are pro-rated on the best available information and represent only rough approximations.

** As indicated above, indirect costs on a functional basis are not captured as part of the Service's administrative accounting system. Estimates, based on the best available information, of the following support activities are included:

Executive Direction
Internal Audit
Management Services
Internal Security
Returns Processing & Computer Services
Tax Information
Appeals
Collection
Regional Counsel & Enforcement Litigation

APPENDIX V

PUBLIC CHARITIES BY CATEGORY
(Rounded to Nearest Hundred)

Section	1982	1981	1980	1979
509(a)(1) 170(b)(1)(A)				
(i)	28,600	26,400	25,500	23,400
(ii)	11,500	11,300	12,000	11,300
(iii)	4,800	4,700	4,800	4,600
(iv)	600	600	600	600
(v)	200	200	200	200
(vi)	98,800	94,300	95,900	90,800
509(a)(2)	108,600	113,100	118,500	114,500
509(a)(3)	11,900	11,700	11,700	11,400
509(a)(4)*	--	--	--	--
Suspense **	2,600	2,800	3,600	3,600
TOTAL	267,600	265,100	272,800	260,400

Source: EO Masterfile Tables

* Less than 50

** Classified as public charities but not as yet specifically coded as 170(b)(1)(A)(i)-(vi) or 509(a)(2)-(4), and also charitable organizations whose foundation status has not been determined.

APPENDIX VI

PRIVATE FOUNDATION ISSUES IN REVENUE RULINGS & PROCEDURES
1970 TO PRESENT

Code Sections	Numbers
507	7
508	14
170(b)(1)(A) & 509	45
4940	12
4941	34
4942	38
4943	5
4944	3
4945	19
4946	5
4947	3
4948	2
Total Issues	187*
Total Published Revenue Rulings & Procedures	167*

*Some Rulings Cover more than one issue, so the sum of the issues covered exceeds the total rulings published.

APPENDIX VII

PRIVATE LETTER RULINGS
ON PRIVATE FOUNDATION EXCISE TAX ISSUES*
(APART FROM THOSE ARISING IN EXEMPTION APPLICATIONS)
1977-1982

Under Code Section	1977	1978	1979	1980	1981	1982	TOTAL
4940	4	11	5	18	10	14	62
4941	36	55	47	59	44	59	300
4942	26	52	50	63	54	76	321
4943	17	25	26	26	30	30	154
4944	2	4	3	7	24	17	57
4945*	19	40	23	51	29	21	183
4945(g)** approval	110	145	187	142	110	188	882
4946	3	4	8	8	9	9	41
4947	2	4	51	68	61	33	219
4948	0	0	2	0	0	0	2
TOTAL	219	340	402	442	371	447	2,221

*This cha[illegible] does not include private letter rulings and determinations issued on foundation issues (sections 507, 508, and 509) arising in exemption applications which amounted to approximately 28,000 in Fiscal Year 1982.

**Estimated.

APPENDIX VIII

Exempt Organizations Examination Coverage
As a Percentage of Entities

I. Private Foundations	1978	1979	1980	1981	1982
Entities examined	2,025	2,689	2,898	2,439	2,646
Active entities	31,319	31,824	32,618	31,866	33,308
Percent examined	6.5%	8.5%	8.9%	7.7%	7.9%
II. IRC 501(c)(3) Public Charities					
Entities examined	2,930	6,003	5,830	4,465	4,431
Active entities	262,628	272,491	287,224	295,892	289,518
Percent examined	1.1%	2.2%	2.0%	1.5%	1.5%
III. All Exempt Organizations (Including I & II)					
Examined	13,260	17,208	18,313	15,463	16,460
Active entities	810,118	824,662	846,492	852,743	872,487
Percent examined	1.6%	2.1%	2.2%	1.8%	1.9%

Sources: EOMF and AIMS tables

APPENDIX IX

PRIVATE FOUNDATIONS
AND OTHER ORGANIZATIONS SUBJECT TO CHAPTER 42
NO CHANGE RATE FOR CHAPTER 42 TAX CHANGES

	1978	1979	1980	1981	1982
All Forms 990-PF	76.9%	82.2%	85.7%	77.4%	81.2%
Under $25,000	95.5	95.3	89.7	92.9	95.2
$25,000 under $100,000	93.1	93.9	85.4	91.4	90.8
$100,000 under $500,000	82.8	84.7	81.5	80.8	86.4
$500,000 under $1 million	76.8	79.4	74.8	77.0	74.3
$1 million and over	72.6	77.5	70.0	71.6	73.1
Form 4720	56.7	62.7	38.1	48.3	53.1
Form 5227 NECT under $100,000	34.2	87.1	94.9	92.5	92.5
Form 5227 NECT $100,000 over	41.3	86.1	88.6	92.2	90.3
Form 1041/1041-A	87.1	61.1	61.1	38.1	89.3
Form 1120 (Revoked PF)	75.0	33.3	73.9	50.0	63.2

Note: IRS examination of the above entities is also concerned with non-tax compliance issues. Thus, the above table does not reflect total enforcement action with such matters as incomplete reporting requirements on returns open to public inspection, and issuance of advisory notification that certain activities may in the future subject the organization to tax.

Source: AIMS Table

Chairman **Rangel**. Mr. Commissioner, is it your testimony that, rather than a dramatic decline in creation of new foundations, there has been, in fact, an increase in foundations as well as increases in contributions?

Mr. **Owens**. Yes, that is correct, Mr. Chairman. There are somewhere in the neighborhood of about 10,000 new private foundations that have been created in the last 10 years according to our figures.

Chairman **Rangel**. Mr. Secretary, when the administration expected the foundations to do more to compensate for the withdrawal of Federal support for domestic programs, were there any policy changes in terms of tax policy recommended so that this could occur?

Mr. **Chapoton**. No, sir, there were no tax policymaking changes. The private effort to fill any gap resulting was not necessarily directed at foundations or charitable activities but to private citizen activities in general.

But in direct answer, no, there were no policy changes recommended.

Chairman **Rangel**. Did members of the administration consult with you as to whether or not the goal of having more private sector involvement could occur with tax changes?

Mr. **Chapoton**. Mr. Chairman, there has been consultation in this area, and specifically on the private foundation area growing out of the President's study of private sector initiatives, but broader tax policy changes, no, as I recall, we had no such discussions.

Chairman **Rangel**. Obviously your testimony supports current tax policy that we should treat differently public charitable organizations as opposed to nonoperating foundations.

Following that line, and recognizing that there is an administration policy that the Federal Government should be involved less in certain activities and the private sector should be involved in more of these activities, I think you would support the position that for one reason or the other, perhaps the 1969 law is a more conservative tax law, that the foundations—or it is perceived so—are involved in more safe and conservative types of grants and awards than those that actually meet some of the social needs in view of the changes that are taking place over the past few years.

Do you believe that this is a proper area for you to be looking into?

Mr. **Chapoton**. I think it is a proper area for the subcommittee and for Treasury to be looking into.

I don't think I would agree that the foundations conduct safer and more conservative activity. Indeed, the argument has been made, and I think there is truth to the argument, that foundations are more flexible and can be more innovative in their approaches to meeting private needs. So the strength of the private foundation community is very vital and I think it is appropriate that this subcommittee review the 1969 act to see if we are undermining the strength.

Our point in our testimony was that there has been a historic difference in treatment of gifts to public charities and private foundations. We are not prepared to recommend that there be a change in that regard. We are saying we would like to review the idea, for example, of raising the 20-percent limit, and removing any administrative impediments in the law that thwart the ability of private foundations to operate.

Chairman Rangel. Do you believe that voter education, voter registration is a proper activity for foundations to be involved in?

Mr. Chapoton. Mr. Chairman, I have not really given that any thought until I heard it mentioned this morning on several occasions. The 1969 act provision requires that voter registration not be carried on with respect to any particular election and be conducted over a broad geographic area. My offhand reaction is those restrictions make a good deal of sense.

Chairman Rangel. Mr. Conable.

Mr. Conable. Thank you, Mr. Chairman. I would like to ask Secretary Chapoton a couple of questions.

I wasn't here to hear your testimony, and if you have answered these in your testimony, please stop me.

I understand you favor including more people under the definition of disqualified persons than the proposals in H.R. 3043 which was limited to children and grandchildren.

Mr. Chapoton. Including fewer people under the definition, not more, fewer people.

Mr. Conable. You want fewer people included under disqualified persons?

Mr. Chapoton. That is right. The argument now is that disqualified persons are all lineal descendants of a donor and it is very difficult to determine who they are. That causes tremendous administrative problems.

Mr. Conable. I misunderstood. You want fewer people disqualified.

Mr. Chapoton. That is correct.

Mr. Conable. That's fine. It does get terribly complicated.

We wanted to hold it to children and grandchildren only. Don't you extend it to lineal descendants?

Mr. Chapoton. It is now extended to all lineal descendants. Our reaction is that limiting it to children and grandchildren might be too restrictive. So we would not be as restrictive as your bill would be, and I think our thinking is that it ought to be——

Mr. Conable. You want more people disqualfied than my bill does.

Mr. Chapoton. If you related to your bill, yes, sir. I was relating to existing law.

Mr. Conable. I see.

What abuses are you looking for? It does get terribly complicated after a while. Anybody with the name similar to that of the founder gets in trouble.

Mr. Chapoton. That is correct. What we are looking for is lineal relatives of the donor who have participated with the foundation or with the business activities that the foundation originally owned, that type of thing.

Mr. Conable. If they are lineal to the founder, it should go on indefinitely?

Mr. Chapoton. No, we don't say it should go on indefinitely. Let me pull that provision out of my statement. We recommended, after quite a bit of discussion, that for example, most lineal descendants not alive when the donor was alive should not be counted. Rules such as that.

Mr. CONABLE. It is a matter of judgment, then, as far as you are concerned.

Mr. CHAPOTON. That is correct. It is just drawing a line. The question is where it should stop.

Mr. CONABLE. I would like to ask you, what is your underlying rationale for keeping the 20-percent contributions limit for gifts to private foundations?

Mr. CHAPOTON. Twenty percent is not a magic number. We suggest that the committee might want to consider raising that limit. I think the real policy issue is whether you keep a differential between private foundations and public charities.

Mr. CONABLE. I have never understood the rationale for that generally. Is it the idea that more broadly based charities somehow have less possibility of abuse?

Mr. CHAPOTON. I think the idea is—this is a longstanding historical treatment——

Mr. CONABLE. I know it is historical. I am trying to get the rationale for using that as precedent.

Mr. CHAPOTON. As we look back at the rules, and it makes sense to us, there was a feeling that gifts to public charities go directly or more quickly into the public stream; that gifts to public charities are used more quickly for charitable activities than is the case if the gift is made to a foundation. With foundations, it is generally the income from the gift or 5 percent of the value, if you will, that goes into the charitable stream.

Mr. CONABLE. We don't draw that regulation though relative to the public charities. We don't insist that the gift go directly into the stream.

Mr. CHAPOTON. That is correct. The feeling is that the public nature of the charity creates sufficient pressure for that result.

It seems to us that that is probably true. I don't think we have any data that proves that conclusively.

Mr. CONABLE. I understand, also, that you favored lessening the impact of rules on expenditure responsibility rather than creating a specific exemption.

Mr. CHAPOTON. That is correct.

Mr. CONABLE. What sort of changes do you have in mind there?

Mr. CHAPOTON. My feeling on the expenditure responsibility rules is that there is a perception that they are very difficult, but once a foundation has been through them one time, they are not so difficult. When you read through the rules, they seem complex.

The basic points—that you ought to have a pre-grant inquiry and an agreement with the grantee relating to how the grantee will use the funds, et cetera, and that you have a report from the grantee—are hard to argue with. So if we can have those basic requirements and somehow lessen the administrative difficulty of imposing them, that is what we ought to seek to do.

The final requirement that there be a report back in the form 990-PF to the Commissioner could be lessened. I don't think there is any magic in that. The fact that it is part of expenditure responsibility and therefore would give rise to the tax, if not complied with, might be a little burdensome.

Mr. CONABLE. Thank you, Mr. Chairman.

Chairman RANGEL. Mr. Thomas.

Mr. THOMAS. Thank you, Mr. Chairman.

Mr. Secretary, you indicated that you agreed in part with Dr. Karl's historical analysis about the flexibility and creativeness of the foundations. Do you agree also with his conclusion that Congress overreacted in 1969 with the passage of the Reform Act?

Mr. CHAPOTON. I don't agree with that total conclusion. I think there are areas that we have discussed—for example, the 2-percent tax and denying the carryover on gifts to private foundations—where that might be true. I would add to that the complexity, which it seems to me is unnecessary, in dealing with the excess business holdings.

The approach of the 1969 act was a meat-axe approach; that is, penalties are applied on very objective rules. It seems that that is good and has had a good effect on the foundation community.

Mr. THOMAS. Do you think that that initial objective application which had a good effect, now in fact might have somewhat of a detrimental effect if we don't go in and be somewhat subjective in dealing with reality after we have required everyone to comply on an objective basis?

Mr. CHAPOTON. I think you have to look at specific problem areas to answer that question, Mr. Thomas. The answer undoubtedly will be yes in some areas, though I think generally speaking my view is the answer would be no.

Mr. THOMAS. You generally agree with the IRS statements about the fact that "current law provides a delicate balance and there are appropriate safeguards"?

Mr. CHAPOTON. Generally I agree with that statement, yes, sir.

Mr. THOMAS. Do you think the Federal tax law should require diversification of the investment assets of private foundations?

Mr. CHAPOTON. No, sir. I don't think the Federal tax law ought to get into diversification questions—as contrasted with the business holding question, I might add.

Mr. THOMAS. Thank you, Mr. Chairman.

Chairman RANGEL. Mr. Secretary, you have mentioned your general support for voter registration when it covers a broad geographic area. It is my understanding from listening to the historians that this rule was designed to prevent partisan involvement in specific elections by requiring the activity to be objective and broad in terms of education and registration.

Would you agree, however, that if there was some other criteria where you could determine that there was a low registration and that there was a need for education and active support to assist the people in getting registered, that as long as it was not involved in a specific campaign or partisan, that there would not be need of a broad geographic restriction?

Before you answer, let me continue.

If you find there is a need in some particular county as opposed to five States, would you not think—and of course there would have to be restrictions that you are not trying to determine the outcome of a specific election or Republican, Democrat, black or white—do you think that requirement of a 5-State effort may be too extreme?

Mr. CHAPOTON. I agree with your initial point. It is hard to disagree with. Voter registration is desirable and what you are saying is if it is done on an objective basis, even though in a limited area, it ought to be allowed. I cannot disagree with that.

I do worry, though, in trying to fashion such a rule as that you might run into the problems that concerned the committee in 1969. So I have to beg off by saying I have not thought about this enough. We have not really discussed it enough to cover that.

Chairman RANGEL. How do you think they saw it in 1969? Were they talking about a specific election?

Mr. CHAPOTON. I think, as I remember, they were talking about specific elections and the concern was that it was for the benefit of one specific party or the other.

Mr. THOMAS. Will the Chairman yield?

Chairman RANGEL. I yield.

Mr. THOMAS. On that point of voter registration, if people are complying with the law, I don't understand why there have to be any restrictions on time, place or manner of registering people to vote.

Would someone explain to me why you would have an advantage if you were legally going out and finding those folks who were eligible to vote and to register them?

Mr. CHAPOTON. Let me say again, Mr. Thomas, I have not been through this recently, but as I remember it, the concern was that by picking a geographical area where you expect the potential voters, if registered, to be of a political persuasion, that a foundation could influence the outcome of a specific election or several elections in that area by having voter registration drives in that area.

Mr. THOMAS. So people registering to vote and exercising their franchise is not necessarily a good thing?

Mr. CHAPOTON. I am not suggesting that at all. I am suggesting that the concern was as I stated it in 1969.

Mr. THOMAS. If the chairman would allow me to continue, I don't know how many foundations were involved in the registering of voters or how many foundations are involved today in the registering of voters. But this has been a recurring theme.

My concern is that we don't go back to some of those supposed activities that we wanted to curb on a specific basis of various activities. I don't understand why, if someone wishes to follow the legal requirements of finding those people who would be eligible to vote if they were registered, there should be any prohibition whatever on the action of any group, whether it be a private foundation, interested citizens or whoever else, to find those people and register them.

Perhaps I am not fully aware of some of the practices that were going on, although I believe I am familiar, after reading some of the history, with the particular practices going on.

My concern is that we don't use Federal tax law either to promote or hinder activities that otherwise are lawful and, in my opinion, very appropriate.

Thank you for yielding, Mr. Chairman.

Chairman RANGEL. I would think that if some of the things that occurred in 1969, as historians would tell us, were emotional, then perhaps this would be a good time to reflect and see whether or not, as Mr. Thomas has pointed out, that Congress did overreact—I certainly can understand the shock and vibrations that electing a black mayor would have in 1969, but I doubt seriously whether most people would get upset about that today.

So it might be as long as we can find restrictions within the law, without violating the standards set for charitable organizations and foundations, that we can get by the hysteria of some Members of Congress, perhaps, in 1969, and come up with something a little more realistic if we truly believe that voter registration improves the quality of the electorate in the United States.

So I would ask—I don't want to use this forum for that discussion—but I ask that you give some thought to that and, also, to see whether or not the administration really believes that in view of cutbacks in health, education, and welfare and the fact that churches, charitable organizations, and so on can go a long way to try to make up for this cutback, as to whether or not there should be any recommendations from Treasury that would encourage people to attempt to do this, whether more incentives should and could be provided.

I am not saying this is the way to go, but since most of the witnesses clearly believe that the President has cause for them to assume all this responsibility, it might be well if we could suggest to them how they might be better able to do it.

Mr. CHAPOTON. That will be fine, Mr. Chairman. We will look at that further.

We have met with some groups, and I am sure we will meet with others as a result of these hearings.

Chairman RANGEL. You have given us a well thought out statement, but you didn't include some of the matters that will be subject to review here, including your willingness to consider legislation and help us draft, were the need to do so presented at these hearings.

So the committee would like for you to be able to answer additional questions and we will continue to work with you.

Mr. CHAPOTON. We will certainly be available and work with the committee.

I have one other thing. We will look with interest on the testimony before the subcommittee. One of the questions that is involved in each of the cases when we are talking about favoring or removing impediments on private foundations and particularly the differential in gifts, which will be the major factor discussed, is whether we are talking about an increase in total charitable giving under the present law, or a decrease, or a shift between the private foundations and public charities.

We have been wrestling with that and I would be interested in what the committee concludes after hearing the witnesses.

Chairman RANGEL. Of course, with some of the recommendations that are in Mr. Conable's bill, those provisions regarding deductibles, there may be a higher tax expenditure cost, would there not?

Mr. CHAPOTON. Yes; the revenue cost of raising the limit, for example, to private foundations is really quite small.

Chairman RANGEL. I was asking, Mr. Conable, whether some of the provisions in your bill might not cause the public charities to lose out on donors as the foundation people would be competing for the same type of contributor.

Would not more competition between the public charities and foundations be evident?

Mr. **Chapoton**. I suspect there would. We have asked the committee whether the public charities would be concerned. The answer is, no, they would have no concern.

I am not sure whether it has been addressed fully.

Chairman **Rangel**. I want to thank you, Mr. Secretary.

I would just like to ask the Commissioner, would you briefly tell us where you have seen abuse with the foundations as related to existing law and regulations?

Mr. **Owens**. Mr. Chairman, I am not sure——

Chairman **Rangel**. You might include whether or not you think that revisions in the law might avoid abuses if it is due to unnecessary burdens on the institutions.

Mr. **Owens**. I am not sure, Mr. Chairman, I can point to any specific area in the current statute where there are abuses occurring.

In our examination of the private foundations and exempt organizations in general, going through the complete examination cycle and examining all those and then the 4 to 6 percent in the last years, we continue to find differences of opinion. Some of those are real differences of opinion; some of them you might question whether or not there was some intent in there or not.

But there is really no specific area that we can point to and say to you we think this really ought to be changed in order to make it more easy to administer.

Chairman **Rangel**. Again, as with the Secretary, we will be in touch with the Service. Probably some of the Members of Congress that are aware of these hearings taking place may also have questions that we have not asked, so we ask you to make yourselves available for that.

When we start coming together to draft recommendations, it might be easier if we can work in an informal way prior to making recommendations to the full committee.

Mr. **Thomas**. One followup on the IRS, if I might. In terms of compliance, you indicated there is no specific area you can see of continuing abuses.

In foundations responding to the 1969 act, is it your perception or has it been discussed, that the primary reason for the disclosure procedures is to make sure that people understand that foundations are not engaged in various activities that have been suggested, or that the requirement of forcing them to go through the procedures of compliance required foundations to change the way in which they were conducting activities?

Mr. **Owens**. Mr. Thomas, my perception is that it is a combination of the two.

Mr. **Thomas**. If you weighted them, which would be greater?

Mr. **Owens**. It would be difficult to weigh them. I don't know whether Al can weigh them, in terms of his day-to-day operations.

Mr. **Winborne**. I don't think I can weigh them, but certainly it was the perception of the bodies down here pre-1969 that there were abuses and that something in the nature of that 1969 Tax Reform Act was needed. It was passed and it has been, as Mr.

Owens said, I think, complied with at an unexpectedly high rate by the foundations.

In other words, the rates have been quite high, in the area of 80 percent or higher. If we could get that compliance throughout the tax code, we would all be much better off. Certainly the publicity requirements have been I think very valuable in the overall effort of compliance, but I would not attempt to rank them or weight them in any other way than that.

Mr. THOMAS. My question is whether or not Congress overreacted. I know it is difficult to determine which one might be the proper motivation.

Your feeling is that going through the procedures required by the 1969 act is good whether it corrected the supposed abuses or whether it merely gave some form of savings to people, that foundations were not in fact involved in those abusive activities to the extent that it ought to be continued with what has been suggested as only, in my opinion, very minimal changes in the law?

Mr. WINBORNE. I might add that there was significant publicity pre-1969. While I was not deeply involved in that at that time, I know that to be a fact.

So the publicity angle alone was not the whole answer to the question. There were changes that were needed in the laws. They were made in 1969.

We think at least from our administrative viewpoint that they have been reasonably complied with and we have had little or no difficulty, certainly in the most recent years, administering them from the standpoint of the IRS.

Mr. THOMAS. Our job is to examine them to determine whether or not we ought to back off on some or increase others.

Thank you, Mr. Chairman.

Mr. WINBORNE. That would be my opinion, yes, sir.

Chairman RANGEL. We thank all of you for helping to set the tone for the hearings.

Mr. CHAPOTON. Thank you, Mr. Chairman.

[The following questions and answers were subsequently received:]

Question 1. The Council on Foundations disagreed with the data base analyses of private foundations (i.e., number, growth rate, assets, etc.) that the Service presented and which the General Accounting Office's statistical study supports. Please describe the methodology the Service used and comment on the apparent discrepancies with the Council's figures.

Answer. In the sections below, we discuss separately our Methodology and Returns Processing Procedures, and the Discrepancies Between IRS and the Council on Foundations' Data.

METHODOLOGY AND RETURNS PROCESSING PROCEDURES

The figures for the number of private foundations are tabulated from our Exempt Organizations Masterfile. Each time the Service recognizes the exempt status of a foundation, or a public charity becomes a private foundation, it is counted in these figures. Conversely, if a foundation goes out of existence or successfully terminates its foundation status and becomes a public charity, It is dropped from this count. We use the statutory definition of a private foundation contained in section 509(a) of the Code. Thus, our masterfile count represents a census of statutorily determined private foundations as of the date given.

The attached "Work-Flow Pipeline" chart shows the processing steps and methodology followed in processing Form 990-PF private foundation returns at our service centers. These returns are the source documents which are used in tabulating the figures for total assets, revenues, expenses and disbursements, etc. The chart traces each step from the time a fundation's return is received in the mail until it is filed for storage and the data on it relayed to the National Computer Center. An Attached narrative also describes each step.

As indicated in the narrative attached to the chart, various validity checks have been implemented at our service centers to ensure the accuracy of our masterfile statistical data. All Form 990-PF return data is first entered by a remote terminal operator which is referred to as Original Entry (OE). For each return, a second terminal operator Key Verifies (KV) this data by duplicating the OE data entries. If there is any discrepancy between the OE and KV entries, the terminal will alert the KV operator of the error, which will then be corrected by the KV operator.

As an additional measure to ensure quality of returns data, all Form 99-PF returns with income and/or asset of $10 million or greater will appear on a service center computer listing. Tax examiners will compare the computer list data with the actual return entries and correct any errors so that only "good" data will post to the masterfile tapes. These high income/asset returns account for approximately 65 percent of any total drawn off of our computer tapes for statistical analysis. These checks and counter checks were implemented to assure us that our computer tabulations are for the most part reasonably accurate.

DISCREPANCIES BETWEEN IRS AND COUNCIL ON FOUNDATIONS' DATA

The IRS statistics for the number of private foundations and the fair market value of assets held by those foundations are not comparable to the data reported by the Council on Foundations. This is because the IRS statistics cover all private foundations as defined in section 509(a), whereas the Council's statistics include only those private foundations that make grants and some large grant-making organizations (community trusts) that, by definition, are public charities and not private foundations.

Most foundations that do not make grants are organizations that directly carry on charitable activities and were classified as public charities until their sources of support changed. Examples are performing arts organizations, research organizations, organizations that conduct educational programs and seminars but do not qualify as schools, handicapped and senior citizens programs other than housing, sports programs for youth, and alcohol and drug treatment centers.

The foundations that do not make grants (and therefore are excluded from the Council's statistics) would also include some of the operating foundations that hold significant assets used directly for charitable purposes, such as museums, libraries, homes for the aged and handicapped, historic buildings and properties, botanical gardens, parks, wilderness areas, and low income housing units.

Once an organization is classified as a private foundation, the Service will continue to treat it on the masterfile as a private foundation for all purposes until the organization terminates its private foundation status.

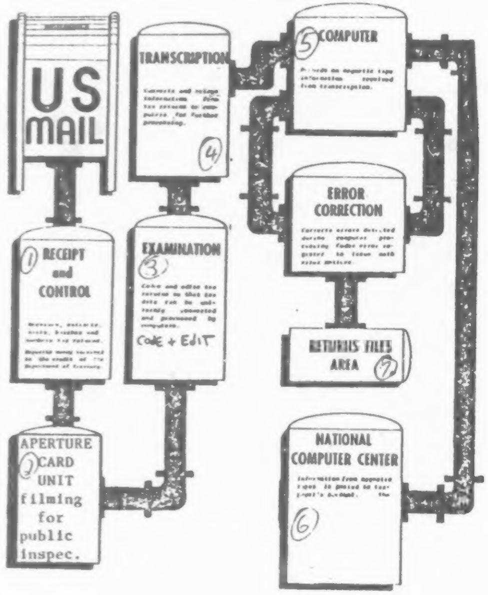
The discrepancies between the IRS' and the Council on Foundations' count of the universe of private foundations are mostly attributable to the differences in definitions. The Service uses the statutory definition while the Council uses a "functional" definition. It is to be noted that the Service's figure includes approximately 5,000 organizations that have been reclassified as private foundations for failing to attract the minimum public support required to maintain status as a public charity. These so-called "burned out" public charities are not grant-making foundations, and since they do not meet the functional definition used by the Council on Foundations, they are not included in the Council's figures.

We seriously question the usefulness of the Council's comparison of pre- and post-1970 data on the rate of growth or decline in the number of foundations, formations, assets, etc., simply because the term private foundation was not statutorily defined before the 1969 Tax Reform Act.

See attached narrative for description of steps on "Work-Flow Pipeline" chart.

WORK-FLOW "PIPELINE"

PRIVATE FOUNDATION RETURNS


US MAIL
① RECEIPT and CONTROL
② APERTURE CARD UNIT filming for public inspec.
EXAMINATION ③
CODE + EDIT
TRANSCRIPTION ④
⑤ COMPUTER
ERROR CORRECTION
NATIONAL COMPUTER CENTER
⑥
RETURNS FILES AREA ⑦

NARRATIVE DESCRIPTION OF STEPS ON "WORK-FLOW PIPELINE" CHART

RETURNS PROCESSING PROCEDURES AT SERVICE CENTERS

The initial action at the service centers involves returns analysis. The purpose of returns analysis is to prepare exempt organizations returns for input to the Automatic Data Processing (ADP) System by perfecting, coding and editing them. A separate sheet of instructions is used for processing each of the exempt organization returns and related forms. The general steps necessary to process private foundation returns for ADP are as follows:

1. Receipt and control

All private foundation returns received by the exempt organizations processing service centers (which include all ten service centers except the Memphis Service Center) are date stamped when received to determine timeliness of filing.

2. Aperture card filming

All private foundation returns and documents that are open for public inspection under section 6104 are sent to the Aperture Card Unit (ACU) within each service center before the code and edit process begins. The ACU photocopies the complete return and attachments (less restrictive data) onto a aperture card, which is a keypunch card with an opening, or aperture, cut out of the card. A piece of film showing up to fifteen pages of a return is mounted in the aperture of each card. This process was implemented to make private foundation returns readily available for public inspection as required by law.

3. Examination—code and edit

A. Editing-General: Service center tax examiners perfect all transcription (keypunch) items as well as other items mentioned in their processing manuals. Each transcription line item is reviewed and if the entry on the line is illegible, or if the line is blank, the service center tax examiner will perfect the line using the following methods:

(a) Examine the rest of the return and attachments for the correct entry.

(b) Compute the correct entry, if possible, from other figures on the return.

(c) Request missing information from the taxpayer if specified as a correspondence item.

B. Common Edit Sheets: Certain codes are used to alert the computer to an unusual condition or to take special action. These codes cause the computer to generate taxpayer notices, delete entities, reject returns, and post or alter data. The most common codes used in exempt organizations return perfection are Computer Condition Codes (CCC) and Audit Indicator Codes (AIC). Condition Codes cause the computer to print the return on the Error or Reject Registers and to post or alter data at the masterfile. Audit Codes are input to alert the computer to generate certain actions because of apparent noncompliance, or result in certain Selection of Exempt Returns for Examination (SERFE) scores for exempt organizations return classification procedures.

C. Entity Perfection: The service centers review each entity portion of the return containing information which identifies the taxpayer on the masterfile, e.g. name, address. Employer Identification Number (EIN), etc. If the taxpayer indicates any changes in these areas the service center will prepare necessary input documents (From 2363-A) to update the account on the masterfile.

D. Correspondence: Exempt organizations returns that are identified for correspondence are suspended in the service centers for a certain time period awaiting reply from the taxpayer. All information originally missing but received through the correspondence effort is eventually sent back to the Aperture Card Unit for refilming for public inspection.

4. Transcription (keypunch)

Upon completion of the code and edit (including correspondence effort) the returns go through a transcription process known as the Direct Data Entry System (DDES). The data transcribed from the returns goes onto magnectic tape. The DDES also performs certain arithmetic and validity checks as the data is transcribed.

5. Computer

The data transcribed on magnectic tape is passed through the service center computer programs to pass additional validity test. The computer checks the information in two ways: first, by checking the taxpayer's computation, and second, by determining that the sum of all returns in a block of returns (usually 100) is in agreement with totals entered for the block. Incorrect data is printed on an Error Register and sent to an Error Correction Section. Here, returns are associated with Registers, errors corrected and the corrections recorded on "good tape". Records that pass all service center validity tests go onto a Return Transaction Tape which produces SERFE scores and other management reports. Certain data from the Return Transaction Tape File is split-off on a Masterfile Tape used to update the Business Masterfile at the National Computer Center in Martinsburg, West Virginia, which will generate refunds or notices on taxpayer accounts.

6. National computer center (NCC)

Documents that make "good" service center tape are processed against the BMF in which they must pass additional computer validity checks before posting to the masterfile. Those documents that do not pass the validity checks are entered on an unposted tape which is then sent back to the originating service center for necessary correction action.

7. Files storage

After completion of the initial processing and posting, exempt organizations returns are maintained at the service center Returns File Unit to be readily available for any adjustment or examination requests. Service centers maintain the return files from six months to a year before returning such documents to their respective federal record centers.

Question 2. Please describe in detail the compliance rate of private foundations with the 1969 rules. What rules are violated in terms of number of foundations and amount of excise taxes imposed and why?

Answer. As indicated in the Service's prepared testimony, we do not have firm statistics on compliance rates for each section of Chapter 42. However, our experience from the five-year examination program, the Taxpayer Compliance Measurement Program (TCMP), and our examination programs since then indicate a relatively high level of compliance with the 1969 rules. Other available information supports this conclusion. See Appendix IX of the prepared statement.

Appendix III. Private Foundation Excise Tax Collections, shows the dollar amount of Chapter 42 tax collections for fiscal years 1971 through 1982. That chart does not disclose the number of violations of each type, however, because the Service does not maintain such statistics. Based on an informal survey, we estimate that most of the Forms 4720 filed this calendar year reported small amounts of section 4942 taxes for failure to distribute income. (Form 4720 is the return used to report Chapter 42 taxes other than the tax on investment income. which is reported on Form 990-PF). We believe that pattterns would be typical of most years and that large tax liabilities and liabilities under sections other than section 4942 arise almost entirely as a result of examinations rather than voluntary reporting by the foundations or disqualified persons liable for the taxes.

Following are figures for the number of Forms 4720 filed to report taxes under section 4941-4945 in the five most recent full calendar years:

Processing year:	*Forms 4720* [1]
1978	1,113
1979	1,492
1980	1,293
1981	1,373
1982	1,487

[1] The number of form 4720 returns filed in each year does not correspond with the number of foundations that were involved in a chapter 42 violation for that year or some prior year. Disqualified persons may be liable for certain Chapter 42 taxes as self-dealers or foundation managers. More than one disqualified person may be liable for tax in connection with the same violation. Disqualified persons with the same tax year as the related private foundation may file on the same form 4720 filed by the foundation, but many choose not to do so and other are not able to because their tax years do not coincide with the foundation involved. Except for section 4945 violations, a form 4720 must be filed to report the tax for each year in the applicable taxable period. Thus, one chapter 42 violation could result in the filing (either voluntarily or as a result of an examination) of a number of forms 4720 for one or more years.

The first Taxpayer Compliance Measurement Program (TCMP) for exempt organization was completed in 1976 and included examinations of about 2,900 private foundations for calendar year 1973 and fiscal years ending in 1974. The projections based on the TCMP examination results were that, if every private foundation were examined for the above period, the following number of Chapter 42 adjustments would have been made:

Internal Revenue Code section:	Number of Adjustments
4941	500
4942	530
4943	10
4944	60
4945	1,000

As measured by dollar amount rather than number of violations, most of the Chapter 42 taxes (excluding section 4940 taxes on investment income) are assessed as a result of examinations rather than from the voluntary reporting of Chapter 42 violations and taxes through the filing of Forms 4720.

The second part of your question asked for an explanation of why Chapter 42 provisions are violated, but from the way your question was phrased, we assume you want to know certain provisions are violated more than others. Our response has been worded accordingly.

On the basis of observations of personnel experienced in this area, section 4945 is the Chapter 42 provision violated most often, although it results in much lower tax collections than sections 4941 and 4942. The main reason for this frequency is that most foundations make a larger number of expenditures, including grants, and section 4945 imposes a tax on each one of them made for proscribed purposes or activities. Certain expenditures are taxable even if made for permitted purposes and activities but specific technical requirements are not met, such as failing to obtain advance approval of grant-making procedures for individuals, failing to exercise expenditure responsibility, and making certain payments to government officials.

Another reason for the greater incidence of section 4945 violations is that violations of other Chapter 42 provisions are sometimes violations of section 4945 as well. For example, the payment of excessive compensation to a foundation manager and the expenditure of foundation funds for the private benefit of a disqualified person are both acts of self-dealing and taxable expenditures, under sections 4941 and 4945, respectively.

Even though the aggregate number of taxable expenditures may be large compared to the number of section 4941 and 4942 violations, the section 4945 tax collections are much smaller than those for the first two Code sections. One reason for this is that the first level section 4945 tax is imposed only once rather than for every year or part of a year that falls within the taxable period, as in the case of section 4941, or for every year that ends within the taxable period, as is the case of section 4942. Another reason is that small foundations are more likely to become liable for the section 4945 tax than larger foundations, so the grants and other payments determined to be subject to tax are relatively small in most cases.

The next most violated provision is section 4941 (self-dealing). These violations run the gamut from unknowing ones made in good faith (such as a bargain sale by a disqualified person to a foundation) to willful ones involving misuse of foundation funds. Section 4941 tax collections are large compared to section 4945 tax collections because the former is imposed not just once but for every year or partial year in the taxable period; because of the pyramiding effect of violations involving leases, loans or other use of property by a foundation or disqualified person; and because the amount involved and subject to tax might involve one or more large transactions (such as a sale of property) rather than a number of small transactions.

Section 4942 taxes account for most of the taxes voluntarily reported on Forms 4720. Many of these violations are inadvertent and result from negligence or mistakes on the part of foundation officials rather than an intent to distribute less than the amount known to be required. Underdistributions sometimes result from the improper treatment of certain expenses as qualifying distributions that should have been treated as deductions in computing adjusted net income. Grants to nonqualifying organizations that give rise to section 4945 tax as taxable expenditures may also result in section 4942 liability if they were taken into account as qualifying distributions when made.

Question 3. How much examination coverage does IRS devote to private foundations in comparison to other exempt organizations and taxpayers generally?

Answer. The Service measures exempt organization examination coverage in terms of the percent of entities examined in a given year. Coverage rates very slightly from year to year, but the coverage rate for private foundations is always higher that the coverage rates for section 501(c)(3) public charities or other exempt organizations. For fiscal years 1978 through 1982, the examination coverage rate for private foundations ranged from 6.47 percent to 8.88 percent. In contrast, the coverage rate for section 501(c)(3) public charities in those years ranged from 1.12 percent to 2.20 percent, and the coverage rate for all other exempt organizations ranged from 1.44 percent to 1.65 percent. In fiscal year 1982, the most recent year that statistics are available, the coverage rates were 7.94 percent for private foundations; 1.53 percent for section 501(c)(3) public charities; and 1.65 percent for all other exempt organizations.

The coverage rates for taxpayers generally are calculated as a percentage of returns filed, rather than entities or individuals. In FY 1982, the overall examination coverage rate, which measures all income, estate, and gift tax returns (other than exempt organization returns) was 1.63 percent.

A more relevant comparison, however, is between the coverage rate for private foundations and the coverage rate for corporate income tax returns in similar assets classes. For fiscal year 1982, as indicated below, the coverage rate for foundations is 9.72 percent and the rate for corporations is 15.59 percent in the asset category of $1 million and over.

PRIVATE FOUNDATIONS [1]

	Entities	Form 990–PF examinations	Coverage rate [2] (percent)
Assets:			
Less than $25,000	13,376	748	5.59
25,000 to 99,000	6,290	531	8.44
100,000 to 499,999	7,257	887	12.22
500,000 to 999,999	2,078	111	5.34
1 million and over	3,785	368	9.72

[1] AIMS and EO/BMF.

[2] This measures forms 990–PF examined as a percentage of private foundation entities. In computing the overall coverage entities, however, the Service measures exempt organization coverage by computing entities examined as a percentage of entities arecognized exempt, because many exempt organizations file more than one return per year, resulting in several examinations per organization. For example, examination of a private foundation's form 990–PF may result in examinations of a form 990–T and several forms 4720.

CORPORATIONS [1]

	Returns filed	Forms 1120 examinations	Coverage rate (percent)
Assets:			
Not reported	144,000	5,359	3.72
Under $100,000	1,035,000	28,864	2.79
$100,000 under $1 million	870,000	39,024	4.49
$1 million and over	221,000	34,458	15.59

[1] 1982 Annual Report, Commissioner and Chief Counsel, Internal Revenue Service, page 50.

Question 4. How are foundations selected for examinations by IRS?

Answer. There are four sources of foundation examinations. They are 1) the Selection of Exempt Returns for Examination (SERFE) system; 2) Automatic returns (automatically sent to the field); 3) Referrals; and 4) Special Programs. Returns sent to the district by any of these sources are then manually screened to determine examination potential.

The Primary source of returns for examination is SERFE, a computerized selection system. Under SERFE, returns are assigned a "score" based on certain criteria. Returns with the highest scores are those with the highest examination potential. When a district requisitions returns for examination under the SERFE system, they are sent the returns with the highest scores.

Certain foundation returns are not included in the SERFE system and are automatically sent to the district for screening. These are a) Form 4720; b) "Final" Forms 990–PF; c) Forms 990–PF filed by private foundations terminating foundation status under section 507(b)(1)(B); and d) Claims for refund of taxes.

Referrals are also a source of returns for examination. Information causing a district to select an organization for examination may come from other IRS functions, other government agencies, or informants alleging noncompliance with the tax laws.

Finally, a foundation may be selected for examination as part of a special program such as the Taxpayer Compliance Measurement Program (TCMP) or the Large Case Program.

Question 5. What specific areas of the 1969 rules require foundations to obtain an advance IRS ruling? How many of those requests receive a ruling and how long does it take IRS to issue such a ruling?

Answer. There are three types of "advance rulings". Strictly speaking, only section 4942(g)(2) set-asides and section 4945(g) grant-making procedures must be approved in advance and require an advance IRS ruling. Advance rulings on the foundation status of newly formed organizations seeking to operate as public charities under section 170(b)(1)(A)(vi) or section 509(a)(2) are a practical necessity, because they are basic to determining whether an organization whose status depends upon a certain mixture of public financial support will be subject to the Chapter 42 provisions. The applicable regulations under those sections allow a new organization up to five years to demonstrate its qualification as a public charity. Other advance rulings about the applicability of the Chapter 42 provisions are viewed as necessary "insurance" by most private foundations.

Section 4942(g)(2)(B) requires a private foundation to obtain an advance ruling approving a set-aside for a charitable project, when the funds for that project will not be expended currently as a qualifying distribution under section 4942(g). Advance Service approval assures the foundation that its set-aside will be treated as a qualifying distribution and not a taxable failure to distribute, as long as the terms of the advance ruling are satisfied. Typical examples of projects for which set-asides are appropriate are construction of buildings, long-term studies, and other charitable endeavors that entail staged financing over a period longer than the normal section 4942 payout period. The Code and the regulations contemplate a five-year limit on set-asides to foster timely charitable expenditures; however, reasonable extensions are approved for good cause, e.g., construction difficulties, material shortages, etc. We estimate that slightly more than 200 of the 300 rulings on section 4942 we issued between 1977 and 1982 covered set-asides. These rulings are generally issued within 60 days of receipt by the Service.

Section 4945(g) requires a private foundation to obtain an advance ruling approving its grant-making procedures so that grants to individuals will be deemed qualifying distributions rather than taxable expenditures under section 4945(d)(3). Section 4945(g) approval is designed to ensure that a private foundation's grants to individuals are made for disinterested charitable purposes as opposed to private (business, political, personal, etc.) purposes. Approval is given to procedures awarding grants to individuals on an objective and nondiscriminatory basis. A grant must be: (1) a scholarship or fellowship (including loans) subject to section 117(a) and for use at a section 170(b)(1)(A)(ii) educational organization, (2) a prize or award under section 74(b), or (3) a grant to achieve a specific objective or enhance the skills of a grantee.

Typically, foundations with scholarship and loan programs under section 4945(g)(1) must demonstrate that the programs are not employment-related, i.e., they must not be structured as compensation substitutes or employment incentives for employees of a particular company (associated with the granting private foundation). Likewise, foundations with grant programs under section 4945(g)(3) must demonstrate that the programs are not structured to further private (business, political, personal, etc.) purposes. During the years 1977–1982, the Service issued approximately 900 advance rulings on section 4945(g). Some of these rulings were requested in conjunction with exemption applications. These rulings are routinely issued within 60 days of receipt by the Service. Nearly all grant-making procedures are eventually approved, because the Service permits private foundations to modify improper procedures to conform with section 4945(g).

As noted earlier, all private foundations, in effect, must have their section 509(a) status determined, because section 508(a) and the applicable regulations require foundations to apply for exemption. Therefore, all private foundations have been classified as such by the Service: 1) upon the initial implementation in the early 1970's of the foundation classification regulations, 2) at the time their exempt status was determined, or 3) after failure to meet the conditions of a section 509 advance or definitive ruling. Many foundations have requested and received supplemental rulings on the effect of proposed transactions on their foundation status.

In addition, private foundations may and do request advance rulings on Chapter 42 questions. These rulings constitute Service opinions on the permissibility and taxability of proposed transactions. The Service issued about 1,100 such rulings between 1977 and 1982.

Question 6. In what specific areas do foundations have the greatest uncertainty when trying to comply with the rules, and where do they need guidance as reflected by requests for advance IRS private letter rulings?

Answer. It is, of course, very difficult to gauge how uncertain private foundations are about the various Chapter 42 rules and why foundations seek rulings on Chapter 42 questions, because measuring perception and motivation is a tenuous task.

The number of rulings issued is an indicator of sorts. Appendix VII of Acting Commissioners Owens' testimony sets out the number of rulings issued by Code section under Chapter 42. For the years 1977-1982 the total number of rulings issued was:

Code section:	*Rulings*
4940 (net investment income)	62
4941 (self-dealing)	300
4942 (minimum payout)	321
4943 (excess business holding)	154
4944 (jeopardizing investments)	57
4945 (taxable expenditures other than 4945(g))	183
4945(g) (advance approval of individual grant procedures)	882
4946 (disqualified person)	41
4947 (nonexempt charitable trusts)	219
4948 (foreign private foundations)	2

These numbers, however, may not be a completely accurate barometer of foundation concern or uncertainty. For example, the fact that advance rulings are required under section 4942(g)(2), relating to set-asides, and section 4945(g), relating to individual grant procedures, probably accounts for the large number of rulings issued on these two sections. Section 4941 and section 4945 (other than section 4945(g)) also generate proportionately large numbers of rulings: but, the wide variety of factual situations covered by these provisions may account for the high number of rulings, rather than inherent uncertainty or confusion about the law. Prudent foundations and other affected parties seek rulings about complex transactions as "insurance" against Chapter 42 taxes on self-dealing and taxable expenditures. Section 4947 and section 4943 generate a relatively high number of rulings. Both sections are rather complex and transactions covered by these sections often involve large amounts of money.

Of course, all foundations must have their section 509 status determined initially. The rules governing section 509(a) (1) and (2) determinations are fairly straightforward, although support calculations can be mathematically intricate. Section 509(a)(3) support relations are more complex and have generated rulings and, in some cases, litigation.

Question 7. Have all the regulations under the 1969 private foundation provisions been promulgated? If not, why?

Answer. All regulations relating to the 1969 private foundation provisions have been promulgated except for one regulation project that relates to excess business holdings of private foundations under Internal Revenue Code section 4943. The bulk of the section 4943 regulations were published in 1977. Because of the complexity of the rules pertaining to corporate reorganizations, regulations relating to these rules were reproposed in 1979. These section 4943 regulations are now under active consideration by the Service and the Department of the Treasury and it is contemplated that final regulations will be adopted by the end of this year.

The Service has other pending regulation projects dealing with private foundations resulting from legislation enacted after the 1969 Act. These regulation projects are (1) Code sections 4941 et seq., second tier excise tax provisions (Public Law 96-596); (2) Code section 4942, private foundation set-asides (Tax Reform Act 1976); (3) Code sections 6033 et seq., return and reporting requirements (Act of Dec. 28, 1980, Public Law 96-603); and (4) Code sections 162 and 4945, political advertising and grass-roots lobbying.

Question 8. Exactly what specific steps must a foundation take to exercise expenditure responsibility with regard to grants to non-public charities?

Answer. Section 4945(h) lists the three elements that constitute maintaining expenditure responsibility in connection with a grant to any organization that is not a public charity. Specifically, a foundation must exert all "reasonable efforts" and establish "adequate procedures": (1) To assure that the grant funds will be used for the intended purpose; (2) to obtain full and complete reports from the grantee on how the funds were used; and (3) to make full and detailed reports to the Internal Revenue Service regarding the use of the grant funds.

The regulations dealing with expenditure responsibility require that the grantor conduct a limited inquiry concerning the potential grantee. These regulations list some factors that should be considered during the pre-grant inquiry, including the identity and prior experience of the grantee, whether the grantee has a history of compliance or noncompliance with the terms of previous grants, and any other relevant information concerning the grantee, its management and its practices that is readily available to the grantor, Ordinarily, no further pre-grant inquiry would be called for if the grantor has made one or more previous grants to the same organization and it has complied with the grant terms, including the submission of the required reports.

As further assurance that the grant funds will be used solely for the intended purpose, any grant to which expenditure responsibility applies must be made subject to a written commitment signed by an appropriate official of the grantee organization. The grantee must agree to repay any portion of the grant not used for the purpose specified, to submit full and complete reports (at least annually) on the use of the funds and the progress made in accomplishing the purpose of the grant, to maintain adequate financial records regarding the use of grant funds, to provide the grantor reasonable access to those records upon request, and not to use the grant funds for any purpose that would be a taxable expenditure if made directly by the grantor. Written agreements incorporating many of the above provisions were often entered into by grantors and grantees before 1970, when there was no legal requirement to do so, and subsequently even if the expenditure responsibility rules do not apply. (Examples include grants by public charities or grants by foundations to public charities.)

The reporting is by means of an attachment to the grantor foundation's annual information return, either Form 990-PF or Form 5227. For any grant subject to expenditure responsibility, the report must be submitted for the year the grant was made and for subsequent periods, if any, during which grant funds remain outstanding or not previously accounted for by the grantor. The report must include the following information: (1) The name and address of the grantee; (2) the date and amount of the grant; (3) the purpose of the grant; (4) the amounts expended by the granteee (based upon the most recent report received from the grantee); (5) the dates of any reports received from the grantee; and reports undertaken by or for the grantor when the grantor had reason to doubt the accuracy or reliability of the reports furnished by the granteee.

Following is the example of expenditure responsibility reporting by the grantor that is contained in the sample Form 990-PF return included in the returns package sent each year to every private foundation on the Service's masterfile. The same sample return is contained in the Form 990-PF instructions that are available at most IRS offices.

Information relating to grants subject to expenditure responsibility:

Grantee—Allen Reid Museum of Fine Arts, 31 Myers Street, Atlanta, Ga. 30301.

Date paid—April 6, 1982. Amount $15,000.

Purpose—For the partial support of a major renovation and expansion of the museum facilities.

Amount of grant spent by grantee—$15,000.

Diversions—To the knowledge of the Foundation, and based on the report furnished by the grantee, no part of the grant has been used for other than its intended purpose.

Date of report for grantee—Final report January 8, 1983.

In addition to its own report covering the use of grant funds, the grantee furnished an independent auditor's report of its operations for its fiscal year ending September 30, 1982. Since this latter report verified the information provided by the grantee, the Oak Foundation, Inc. deemed further verification of the grantee's report unnecessary.

Question 9. How does the IRS monitor the investment policies and administrative expenses of foundations, including trustee compensation? At what point do investment policies and administrative expenses become improper under current law?

Answer. Investment policies and administrative expenses are distinct areas, so they will be discussed separately below.

INVESTMENTS

In monitoring a foundation's investment policies, the Service looks primarily for Chapter 42 implications such as the following:

Section 4941 (self-dealing).—Purchases, leases and loans between a foundation and disqualified persons; purchases or sales of securities by a foundation to manipulate the price of a security for the benefit of a disqualified person—all of us above may constitute acts of self-dealing.

Section 4942 (income distribution requirements).—Program-related investments (investments made primarily to accomplish some charitable purpose rather than to produce income) may be treated as qualifying distributions when made. Proper valuation of investment assets is essential for a correct computation of the payout requirement based on minimum investment return.

Section 4943 (excess business holdings).—Investment acquisitions by the foundation or its disqualified persons may result in the foundation's having excess business holdings immediately subject to the tax or that must be disposed of within a specific period of time to avoid the section 4943 tax. Excess holdings held on 5/26/69 must be disposed of timely to avoid the tax.

Section 4944 (jeopardizing investments).—Speculative investments that jeopardize a foundation's ability to accomplish its charitable purposes are subject to tax.

Section 4945 (taxable expenditures).—Special expenditure responsibility rules apply to program-related investments. Also, the purchase of investments from disqualified persons for more than fair market value and the sale of investments to disqualified persons for less than fair market value would be both taxable expenditures by the foundation and acts of self-dealing by the disqualified persons involved.

The Service does not investigate whether the managers of a foundation try to maximize the return on the foundation's investments and the funds available for investment. If the trustees of a large foundation kept all of its funds in a non-interest bearing checking account in an unrelated bank, this policy of not investing any available funds would not constitute by itself a Chapter 42 violation nor cause the loss of the foundation's tax exemption. This arrangement could, of course, lead to diminution of principal in order to satisfy the section 4942 minimum payout requirement. Also, the policy could be counter to the laws of a number of states that impose certain fiduciary responsibilities on the officers, directors and trustees of charitable organizations. There is no counterpart in any federal law or regulation administered by the Internal Revenue Service.

ADMINISTRATIVE EXPENSES

Some states that regulate charitable organizations that solicit contributions from the general public set specific limitations on the percentage of expenditures an organization may have for fund-raising activities and, in some cases, for the management and general expenses of the organization. Organizations that do not meet the percentage limitations of a particular state generally are barred from soliciting contributions in that state. There is no federal counterpart to these state laws.

Excessive compensation to foundation managers and other disqualified persons would constitute self-dealing taxable to the disqualified persons involved and, at the same time, might result in tax under sections 4942 and 4945.

The Service has no specific published quidelines on what is reasonable compensation for managers of foundations of various types or sizes. A facts and circumstances test must be employed in each case, just as in the case of section 162(a)(1) which allows a business expense deduction for "a reasonable allowance for salaries or other compensation for personal services actually rendered". Section 53.4941(d)-3(c) of the Foundation Excise Tax Regulations specifically refers to section 1.162-7 of the Income Tax Regulations for determining excessive compensation.

Chairman **Rangel**. The next panel will be State law enforcement officials who have had responsibility of recognizing and enforcing the laws as related to trusts and foundations.

We have Neil Hartigan, attorney general, State of Illinois; James Cordi, deputy attorney general, State of California; and Jonathan Silberman, from my State, section chief, not-for-profit organizations section, charities, trusts and estates bureau, office of the attorney general, State of New York.

Mr. Hayes.

STATEMENT OF MICHAEL J. HAYES, ASSISTANT ATTORNEY GENERAL, ON BEHALF OF NEIL HARTIGAN, ATTORNEY GENERAL, STATE OF ILLINOIS

Mr. **Hayes**. Mr. Chairman and members of the subcommittee, good afternoon.

Attorney General Hartigan sends his best wishes to the subcommittee and commends you on undertaking what he considers to be a very important task. The attorney general learned last evening that he would have to appear before the Illinois Legislature this morning to testify on matters concerning the attorney general's budget.

Let me say that I am honored to have been asked to stand in for the attorney general, and I appreciate the opportunity to appear before the subcommittee.

Attorney General Hartigan asked me to deliver the statement.

The attorney general of the State of Illinois is responsible for administration and supervision of charitable foundations located in Illinois. There are approximately 3,500 private foundations registered with the office of the attorney general.

The statutes of the State of Illinois specifically incorporate many of the Federal private foundation rules, including the prohibition against private foundations and their managers engaging in acts of self dealing as defined in section 4941(d) of the Internal Revenue Code; the prohibition against private foundations owning active businesses as provided for in section 4943(c) of the code; the prohibition against jeopardy investments as defined in section 4944 of the code; and finally, the prohibition against taxable expenditures as defined in section 4945(d) of the code.

Your committee has asked for information to assist you in determining whether the current rules governing foundations enacted by the Tax Reform Act of 1969 insure that only those private foundations operating for the public benefit enjoy favorable tax treatment without imposing unnecessary or unduly burdensome restrictions.

I believe that, in general, the present rules governing private foundations are not unduly or unnecessarily burdensome. The vast majority of Illinois private foundations subject to the administration and supervision of the attorney general do comply with the private foundation rules.

Only a few foundations are involved in any violation of the private foundation rules. Any violations of the private foundation rules arise generally in relatively small private foundations whose managers are unfamiliar with or not properly advised as to their responsibilities.

In general, private foundations in Illinois reflect the so-called "prudent man rule" in regard to their investments and are in compliance with section 4944. Private foundations do not engage in speculative investments and generally their assets contain marketable securities and real estate holdings appropriate for ownership by a private foundation.

Very occasionally foundations have invested in low yield assets, but in almost all cases have been able to make their minimum section 4942 payout requirement. In general, the administrative expenses, including trustee compensation, do not represent an inordinate proportion of the qualifying distributions of private foundations.

I have several suggestions for possible improvements in the private foundation rules.

First, under current law, all excise taxes collected under chapter 42 of the code are remitted to the Federal Government. As a practical matter, these excise taxes, which reflect penalties for violations of the private foundation rules, are paid out of the assets of the private foundation involved in the violation.

The net result is that the coffers of the private foundation located within the State are depleted, with a consequent reduction in the pool of assets available to fund future distribution to charitable donees.

I recommend that a portion of these penalty taxes be remitted to the State of principle office of the private foundation in question. The State would then have the option of earmarking these funds for charities located within its borders or for other programs for the benefit of its citizens.

This remission of a portion of the penalty taxes would insure that the State would, to some extent, be reimbursed for the lost charitable distributions resulting from the depleted endowments of the foundations subject to the penalties.

A related suggestion concerns the 2 percent section 4940 tax. This tax was imposed not as a revenue raising measure but to offset the cost of auditing private foundations. My undertanding is that the section 4940 tax at this point in time is more than sufficient to provide for the expenditures of the Federal Government in reviewing compliance with chapter 42.

I recommend that the excess—revenues above expenditures—of this tax be rebated to the State where the foundation is incorporated or State of principal office of the foundation to help defray the expenses incurred by the State in supervising those foundations. A portion of that revenue would be of great benefit to the States in carrying out their own monitoring of charitable organizations.

I also have a general comment in regard to the interaction between the Federal and State agencies in their roles in supervising private foundations. In many cases, the attorney general's office is not aware that the Federal Government has been engaged in an audit of a private foundation until the audit has been completed and the excise tax imposed.

As a result, the attorney general is placed in the position of approaching the foundation managers after the Federal audit is complete to require them to make restitution to the foundation for the excise taxes paid to the Federal Government.

It would be helpful if the office of the attorney general or other State official charged with the administration or supervision of the private foundations be informed when the Federal Government is engaged in an audit of a private foundation. This would assist the State official in coordinating his review and procedures with those of the Federal Government and would also impose less of a burden on the foundation managers in dealing with both State and Federal levels of review.

Your committee has asked for comment in regard to what areas the current private foundation rules might be unduly burdensome.

One area in which the rules are unduly restrictive is the current 5-year divestiture requirement for business holdings acquired by gift or bequest. I am in agreement with the intended purpose of section 4943. The continued control of family businesses by family members of the donor has the potential of diverting foundations from their legitimate charitable duties. However, in such circumstances, relief from the divestiture rules would be appropriate.

Such instances would include the situation where a private foundation has diligently throughout the entire 5-year period attempted to divest itself of its business holdings, but has been unable to do so because of unusual circumstances.

Examples of unusual circumstances might include a substantial gift of an operating business of exceptional size and diversity, which, by its very nature, results in few buyers capable of, or interested in, acquiring the business interest. Other factors would include litigation pending against the foundation which prohibits divestiture or limitations imposed by statute or regulations prescribed by a governmental body which inhibit divestiture, both of which are examples of circumstances beyond the control of the foundation managers which prohibit the sale of the business.

We have a divestiture problem in Illinois involving the John D. and Catherine T. MacArthur Foundation, the "Foundation," which is an Illinois not-for-profit corporation. The foundation received all of the stock of Bankers Life & Casualty Co. "Bankers," a large and diversified insurance business incorporated under the laws of the State of Illinois.

The MacArthur Foundation is currently subject to a divestiture deadline of November 30, 1983. I understand that data and testimony will be provided by other witnesses as to the inherent difficulties of a sale of an enterprise of the size and complexity of Bankers. At this point, it seems virtually certain that no purchaser will emerge in time to allow the divestiture to be completed by the November 30, 1983, deadline.

The MacArthur Foundation has a distinguished board and in its short 5-year history, has made an important contribution to the State of Illinois and to the Nation at large.

The board of directors of the foundation presently consists of 11 members, all of whom are individuals of national eminence and stature. They include my colleague, John E. Corbally, former president of the University of Illinois; Gaylord Freeman, former chairman of the board of the First National Bank of Chicago; Murray Gell-Mann, a Nobel laureate; Edward H. Levi, former Attorney General of the United States; Jonas Salk, developer of the polio vaccine which bears his name; J. Roderick MacArthur, son of John D. MacArthur; William T. Kirby, general counsel of the foundation; and Jerome B. Wiesner, former president of the Massachusetts Institute of Technology. Members of the family of John MacArthur do not control the activities of the MacArthur Foundation, as J. Roderick MacArthur is only one member of the 11 active board members.

It is my understanding that the foundation board as presently constituted was elected partly in recognition that the requirement of divestiture imposed on the foundation would require the participation and contribution of people of unquestionable integrity and skill. The hope was that this group of exceptionally talented people would be able to marshal the forces necessary to dispose of the foundation's holdings in Bankers within the divestiture period for a price which would reflect the true market value of those shares.

I am generally familiar with the efforts made by the directors to sell those shares. Their efforts have continued on an uninterrupted basis during the entire 5-year period and have involved contacts with hundreds of potential purchasers throughout the United States and abroad.

However, despite their efforts, I understand that no purchaser has been found.

At this point, the MacArthur Foundation is faced with a distress sale. A distress sale will mean that the assets of the foundation will be liquidated at a price substantially below the value that they would generate if the sale could be made in the normal course of business.

Inevitably, the foundation's endowment base will be eroded. This erosion will mean that the foundation will be unable to continue its program of charitable giving on the scale and with the creativity and diversity which the foundation has demonstrated in the 5 years of its existence.

I would like to focus attention on the detriment to the citizens of the State of Illinois and the American public in general when the assets of any such foundation are disposed of in a distress sale.

Because of the close connection of John D. MacArthur to Chicago and to Illinois, the foundation through its special grants program has made extensive grants in Illinois. In 1980 and 1981 alone, the foundation grants to Illinois charitable organizations totaled over $12 million, including grants to many local community groups which would not normally have access to funds to carry out their charitable purposes.

The foundation has also supported organizations concerned with urban problems and human needs, including particularly the needs of disadvantaged and minority youth, high school dropouts, and unwed teenage mothers. I regard grants of this nature as crucial to the revitalization of the core city and to aid minority groups and urban poor.

The foundation has undertaken programs and activities which would not be appropriate for Federal or State governments to pursue. An example would be the grant to Harper's Magazine Foundation, which is devoted to preserving the 130-year-old Harper's magazine, a literary periodical which has throughout its history served as an important forum for literary works, particularly by new authors, and for the advancement of intellectual thought.

It seems to me that the foundation has been characterized by initiative and creativity in responding to public needs. Rather than merely passively responding to social problems or demands for funding, the foundation has reached out in unusual and creative ways.

The Prize Fellows Program, which has received so much favorable publicity for its grants to individuals of unusual creativity and productivity, is a case in point. The health program, which supports research into mental health, is a further example of the foundation's resourcefulness, in attempting to fill a void in medical research.

I believe the MacArthur Foundation has responded well to the President's call for increased voluntarism and private sector initiative.

I support legislation which would authorize the Secretary of the Treasury to grant extensions if a foundation can demonstrate its need for additional time. Such legislation is appropriate and in the public interest.

H.R. 2032, introduced by Congressmen Russo and Conable, incorporates provisions of the type which I am proposing. In my opinion, H.R. 2032 is consistent with the congressional intent underlying section 4943 for it obligates a foundation to demonstrate to the satisfaction of the Secretary of the Treasury its good faith attempts to dispose of the prescribed ownership in active businesses.

The monitoring function which the Secretary of the Treasury is thus enabled to perform insures compliance with section 4943 while providing flexibility for conditions which the foundation cannot control. I therefore support H.R. 2032 which would authorize temporary relief from divestiture by granting extensions in those circumstances beyond the foundation's control.

Respectfully submitted, Neil F. Hartigan, attorney general of the State of Illinois.

Chairman RANGEL. Thank you very much.

It is clear the MacArthur Foundation has made a favorable impression on the attorney general's office. Are they based in Chicago?

Mr. HAYES. Yes, that is correct.

Chairman RANGEL. I assume it has been brought to the attention of the chairman of this committee.

Mr. Cordi.

STATEMENT OF JAMES CORDI, DEPUTY ATTORNEY GENERAL, ON BEHALF OF JOHN K. VAN DE KAMP, ATTORNEY GENERAL, STATE OF CALIFORNIA

Mr. CORDI. Mr. Chairman and members of the subcommittee, thank you for your invitation to the California attorney general to present evidence reflecting our charitable trust enforcement experience, the role of private foundations in California and the impact of Federal tax laws on California's enforcement efforts with respect to private foundations. On behalf of attorney general, Van de Kamp, I am pleased to do so.

My testimony today will highlight some of California's significant charitable trust enforcement activity and outline specific problems related to Federal tax law for tax-exempt charitable organizations that have surfaced in the course of charitable private foundation enforcement actions brought by my office.

First, some background on California's charitable trust enforcement program. The California attorney general has extensive powers to supervise and enforce charitable trusts, derived from statutory and case law. A statutory system of registration and annual financial reporting by California charities to the attorney general's registry of charitable trusts provides current data on the financial condition and administration of registered charities in California.

As of June 1983, the California Registry of Charitable Trusts reported 50,500 registered charitable organizations in California, with 38,000 classified as active. These figures exclude approximately 20,000 additional California charities that are exempt from registration—churches, hospitals, educational institutions. Registered charitable organizations reported total revenue, as of May 1983, of $13.7 billion and total assets of $17.3 billion. Based on IRS data for 1980, there are approximately 3,200 private foundations registered in California, averaging total assets of $4 billion.

The primary purpose of the California attorney general's program for charitable supervision and enforcement is to prevent charity abuses and to detect and recover for the public beneficiaries funds and assets that are wrongfully diverted from charities in California. During the last 15 years of the California attorney general's active charitable enforcement work, the most significant legal actions have involved the following major target areas:

One, detection and corrective legal action against diversion by insiders of charitable assets, including blatant self-dealing and personal use of charity funds; two, challenges to trustees' requests for exorbitant fees; three, attempts to identify and curtail manipulation of charitable assets for the benefit of corporate insiders and controlling donors, and to prevent proposed sales of foundation corporate stock at prices below market.

The attorney general reported 797 active charitable trust enforcement actions pending as of most current available budget data, 1981–82. The attorney general's charitable trusts enforcement section is presently staffed by six full-time attorneys, eight auditors and a registrar and deputy registrar of the registry of charitable trusts.

Private foundations in California have presented special enforcement problems. As noted earlier, 1983 IRS data reflects that private foundations registered in California number approximately 3,200 and account for $4 billion in total assets and $1.25 billion in revenue. Most current figures on grants made by California private foundations reflect $310 million in grants for the year ending 1980.

Private foundations have figured prominently in California's charitable enforcement experience, and have raised problems in four major categories: divestiture of excess business holdings complicated by economic market factors and early deadlines contributing to distress sale conditions, and also by insider conflicts of interest; self-dealing and payment of unreasonably high fees to trustees and attorneys of private foundations; questionable investment policies and practices by trustees; and the loss of charitable assets through assessment by IRS of first-level taxable expenditures penalties and other fines against private foundation assets, rather than individual manager/trustees. These experiences suggest several key areas for review and revision of existing Federal tax laws.

There are five problem areas among private foundations in California related to Federal tax law. It is clear that the 1969 Tax Reform Act has curtailed many private foundation abuses and discouraged the use of foundation funds for personal interests, particularly where the foundation is controlled by a family or corporation. However, the California enforcement experience has revealed continuing practices by private foundation managers and trustees that appear contrary to public interest and to the philosophy underlying the 1969 Tax Reform Act. We summarize these questionable practices in the context of the following five topical questions presented for the committee's consideration.

One, is present Federal tax law adequate to control management fees and administrative expenses of private foundations? W. M. Keck, the founder and principal shareholder of Superior Oil Co., died and left 10 percent of the outstanding shares of stock in Superior Oil Co. to the W. M. Keck Trust, a California testamentary trust, for the benefit of the W. M. Keck Foundation, a California charitable private foundation. The sole living trustee of the W. M. Keck Trust is Howard Keck, surviving son of donor W. M. Keck; Howard Keck serves also as the former chairman and current director of Superior Oil Co., and as one of the directors of the W. M. Keck Foundation.

Howard Keck's responsibilities as trustee of the W. M. Keck Trust include administering the trust assets—stock in Superior Oil Co.—and distributing income to the W. M. Keck Foundation annually to meet the minimum distribution for exempt purposes requirements imposed by IRC section 4942. For these services, Howard Keck has sought California probate court approval of a $1 million fee to himself—and his now deceased brother, who until his death was cotrustee—for 2 of the 3 years in which the W. M. Keck Trust has accounted to the court. Since 1980, the California attorney general has engaged in extensive litigation and negotiations to challenge these requested fees as excessive and unreasonable.

Notwithstanding litigation, Howard Keck—and his brother—received $1.37 million in total fees for the first 2 years of Keck Trust administration. A fee request for $859,000 for the third year of trust administration is currently pending before the Los Angeles County Probate Court. Mr. Keck justifies these fees by relying on the enormous value of the trust's assets, Superior Oil Co. stock, which has ranged in fair market value between $250 million and $446 million during the existence of the trust.

While California's efforts through litigation and negotiation have resulted in some reduction in these trustee fees, our office is not convinced that this type of fee problem could not be resolved more efficiently through application of Federal tax law restriction against self-dealing by a disqualified person and prohibitions on excessive and unnecessary payments to disqualified persons by private foundations.

We recommend that this oversight subcommittee inquire into the availability of existing Federal tax law enforcement tools to address cases of self-dealing and conflict of interest in the exercise of discretionary trustee powers. We suggest that the subcommittee consider amending Federal tax law on self-dealing to impose guidelines or limitations on fees and administrative expenses paid to disqualified persons, possibly to a percentage of annual income or qualifying distributions for exempt purposes.

Two, are conduit/flow-through private foundations, in which one private foundations makes grants to another, fostering waste, duplication and delay in the making of charitable grants? The W. M. Keck Trust and W. M. Keck Foundation, as described in the preceding section, point out the potential for double administrative expense, inefficiency and delay in charitable private foundation administration where two related conduit private foundations are permitted to carry out one charitable exempt purpose.

We suggest that the oversight subcommittee reevaluate the merits of conduit private foundations and consider at a minimum more stringent provisions for early distribution to qualified exempt organizations and guidelines or limitations on fees and administrative expenses to minimize duplication and waste of assets.

Three, should Federal tax law require diversification of the investment assets of private foundations? During California's charitable enforcement experience, it has been noted that minimal diversification of investment assets among private foundations appears regularly. Tax planning considerations, coupled with a donor's desire to maintain family control of corporate stock, appear to contribute to this situation.

The W. M. Keck Trust exemplifies this arrangement, in a context where even IRC section 4943 provisions for divestiture of excess business holdings of 20 percent of outstanding stock will not come into play, since the trust and disqualified persons together hold less than 20 percent of the Superior Oil Co. stock.

We suggest that IRC section 4944 provisions against jeopardizing investments be reviewed for possible amendment by addition of a provision requiring private foundation trustees and managers to take timely and reasonable steps to diversify foundation investments. At minimum, Federal tax law should alert private foundation managers to the commonly accepted principles of prudent investment management in which diversification is normally an essential component.

Four, should penalty taxes on disallowed private foundation activities be assessed exclusively against foundation managers and/or disqualified persons, rather than against the foundation's charitable assets?

The William Turner Trust in California is an example of counterproductive tax law enforcement and of duplication in enforcement efforts resulting from the automatic imposition of first level penalties on private foundations. The Turner Trust was assessed $5,000 by IRS for first level penalty taxes under IRC section 4945, for taxable expenditures in the form of grants made by disinterested trustees to remote relatives of the donor. The $5,000 was paid from the charitable trust assets, which came to the attention of the California attorney general.

The attorney general brought a civil action in State court against the trustees and successfully recovered for the foundation the $5,000 fine, plus another $5,000 in legal fees which the trustees had sought to pay from the foundation's assets to their own attorneys. Considerable attorney time was required in this case, as in other similar California cases, and was allocated due to the important principle at stake rather than the monetary amounts involved.

We support such changes, including abatement of penalties assessed against private foundation assets. Penalties should be administered to deter improper or wrongful activity by private foundation managers, not to reduce the flow of urgently needed charitable funds into the public sector.

Five, is more flexibility needed in the divestiture requirements for excess business holdings? Divestiture of excess business holdings exceeding 20 percent of voting stock, IRC section 4943.

The William Gilmore Foundation is a California private foundation which holds excess business holdings consisting of stock in the Gilmore Steel Co. The foundation and Gilmore Steel Co. have common directors. Under present Federal tax law, the foundation must divest its excess business holdings within approximately 14 months or face the penalty of taxes imposed by IRC section 4943. The foundation has received a purchase offer for its stock from Gilmore Steel Co. at a price well below book value and unacceptable to the California attorney general, who, under California Corporations Code section 5913 receives advance notice of sales of substantial assets by California charitable corporations.

The Gilmore Foundation problem reflects an unfortunate concurrence of depressed economic conditions in the steel industry, a condition of urgency as the time limit for avoiding penalties approaches, and a foundation without the benefit of completely disinterested trustees.

We suggest that amendments to IRC section 4943 be considered to impose on foundation managers a continuing duty from the time of receipt of excess business holdings to use their best efforts to divest such holdings at the best available price, and to report on their efforts in the annual foundation return, 990-PF. Foundations should be required to expose their excess business holdings to the broadest possible market, particularly where sales involve potential conflicts of interest.

As a disincentive to distress sales to disqualified persons, we suggest a new provision against unjust enrichment: If a sale is made to a disqualified person who resells at a substantial profit within 5 years, the disqualified person should be required to repay to the foundation a percentage of such profit.

The California attorney general's charitable trusts staff is available to supply any supplemental case files, registry statistics or other data required by the oversight committee. Please direct all such inquiries to the attention of Assistant Attorney General Carole Ritts Kornblum, 6000 State Building, San Francisco, Calif. 94102; 415-557-2645.

Thank you for the opportunity to share with your committee some of California's experience and concepts for improved charitable trust enforcement.

Chairman RANGEL. Thank you.

[Letters follow:]

STATE OF CALIFORNIA, DEPARTMENT OF JUSTICE,
San Francisco, Calif., June 21, 1983.

Hon. CHARLES B. RANGEL,
Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives, Washington, D.C.

DEAR REPRESENTATIVE RANGEL: Thank you for the invitation on behalf of the Oversight Subcommittee of the House Committee on Ways and Means to present evidence reflecting the California Attorney General's charitable trust enforcement experience, the role of private foundations in California, and the impact of Federal tax laws on California's enforcement efforts with respect to private foundations.

This letter highlights some of California's significant charitable trust enforcement activities and outlines specific problems related to Federal tax law for tax-exempt charitable organizations that have surfaced in the course of charitable private foundation enforcement actions brought by this office.

BACKGROUND ON CALIFORNIA'S CHARITABLE TRUST ENFORCEMENT PROGRAM

The California Attorney General has extensive powers to supervise and enforce charitable trusts, derived from statutory and case law. A statutory system of registration and annual financial reporting by California charities to the Attorney General's Registry of Charitable Trusts provides current data on the financial condition and the administration of registered charities in California.[1] The duties of charitable trustees under California laws with respect to management of assets, self dealing, standard of care and investments vary according to the legal form of organization assumed by the charity, e.g., nonprofit corporation (public benefit, mutual benefit or religious) or trust. The scope of the Attorney General's enforcement authority varies according to the purposes of the charitable organization; generally, broad authority exists to investigate, audit, bring civil and criminal actions for diversion of charitable assets, mismanagement and imprudent loss of assets, self dealing by directors/trustees, removal of directors/trustees and involuntary dissolution, imposition of constructive trust, and to invoke other appropriate equitable remedies to protect and preserve charitable assets. The development of California's comprehensive statutory scheme for charitable trust enforcement and the history of the California Attorney General's charitable trust enforcement activities are outlined in considerable detail in the enclosed law review article published in the 1979 University of San Francisco Law Review.[2]

SUPERVISION AND ENFORCEMENT OF CALIFORNIA'S $17 BILLION CHARITABLE SECTOR

As of June 1983, the California Registry of Charitable Trusts reported 50,500 registered charitable organizations in California, with 38,000 classified as "active." These figures exclude approximately 20,000 additional California charities that are exempt from registration (churches, hospitals, educational institutions). Registered charitable organizations reported total revenue, as of May 1983, of $13.7 billion and total assets of $17.3 billion. Based on IRS returns for 1980, there are approximately 3,200 private foundations registered in California, averaging total assets of $4 billion.[3]

The primary purpose of the California Attorney General's program for charitable supervision and enforcement is to prevent charity abuses and to detect and recover for the public beneficiaries funds and assets that are wrongfully diverted from charities in California.

During the last fifteen years of the California Attorney General's active charitable enforcement work, the most significant legal actions have involved the following major target areas:

(1) Detection and corrective legal action against diversion by insiders of charitable assets, including blatant self dealing and personal use of charity funds by directors *(People* v. *Larkin (Kay Foundation))*—S.F.; Animal Protection Institutes—S.F.; *People* v. *McPhee (Geo. Sandy Foundation)*—S.F.;

(2) Attorney General's challenges to trustee's requests for exorbitant fees (Est. Gladstone—L.A.; Keck Foundation—L.A.; Getty Estate—L.A.);

(3) Attempts to identify and curtail manipulation of charitable assets for the benefit of corporate insiders and controlling donors (Irvine Foundation—L.A.; Ahmanson Foundation—L.A.) and to prevent proposed sales of foundation corporate stock at prices below market (Wm. Gilmore Foundation—S.F.); and

(4) Prior to 1981 legislation severely limiting the Attorney General's civil fraud enforcement jurisdiction over religious corporations (Calif. Corp. Code § 9230), this office was actively litigating three cases of alleged misuse of religious corporation assets by insiders (Synanon, Inc.—S.F.; Worldwide Church of God—L.A.; Faith Center—L.A.).

The major cases cited above[4] were discovered through complaints from former directors and insiders, from members, from other governmental agencies, from private attorneys and from Registry information.

The Attorney General reported 797 active charitable trust enforcement actions pending as of most current available budget data (1981-82). The Attorney General's charitable trusts enforcement section is presently staffed by six full-time attorneys, eight auditors, and a Registrar and Deputy Registrar of the Registry of Charitable Trusts.

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[1] California Government Code sections 12580-12596.

[2] Abbott and Kornblum, "The Jurisdiction of the Attorney General Over Corporate Fiduciaries Under the New California Nonprofit Corporation Law," 13 U.S.F. Law Review 753 (1979).

[3] Statistics supplied April, 1983, by California Registrar Larry Campbell and from IRS 1982 data for 501(c)(3) organizations.

[4] Case citations are contained in the attached law review article, 13 U.S.F. Law Reivew 753 (1979).

PRIVATE FOUNDATIONS IN CALIFORNIA: SPECIAL ENFORCEMENT PROBLEMS

As noted earlier, 1983 IRS data reflects that private foundations registered in California number approximately 3,200 and account for $4 billion in total assets and $1.25 billion in revenue. Most current figures on grants made by California private foundations reflect $310 million grants for the year ending 1980.[5]

Private foundations have figured prominently in California's charitable enforcement experience, and have raised problems in four major categories: divestiture of excess business holdings complicated by economic market factors and early deadlines contributing to "distress sale" conditions, and also by insider conflicts of interest; self dealing and payment of unreasonably high fees to trustees and attorneys of private foundations; questionable investment policies and practices by trustees; and the loss of charitable assets through assessment by IRS of first-level taxable expenditures penalties and other fines against private foundation assets, rather than individual manager/trustees. These experiences, which are summarized in the following section, suggest several key areas for review and revision of existing Federal tax laws.

FIVE PROBLEM AREAS AMONG PRIVATE FOUNDATIONS IN CALIFORNIA RELATED TO FEDERAL TAX LAW

It is clear that the 1969 Tax Reform Act[6] has curtailed many private foundation abuses and discouraged the use of foundation funds for personal interests, particularly where the foundation is controlled by a family or corporation. However, the California enforcement experience has revealed continuing practices by private foundation managers and trustees that appear contrary to public interest and to the philosophy underlying the 1969 Tax Reform Act. We summarize these questionable practices in the context of the following five topical questions presented for the committee's consideration:

(1) Is present Federal tax law adequate to control management fees and administrative expenses of private foundations?

(2) Are conduit/flow-through private foundations, in which one private foundation makes grants to another, fostering waste, duplication and delay in the making of charitable grants?

(3) Should Federal tax law require diversification of the investment assets of private foundations?

(4) Should penalty taxes on disallowed private foundation activities be assessed exclusively against foundation managers and/or disqualified persons, rather than against the foundation's charitable assets?

(5) Is more flexibility needed in the divestiture requirements for excess business holdings?

(1) Is present Federal Tax law adequate to control management fees and administrative expenses of private foundations? (Sanctions against self dealing (I.R.C. § 4941); payment of compensation to a disqualified person (I.R.C. § 4941(d)(1)(D))

W. M. KECK TRUST AND W. M. KECK FOUNDATION

W. M. Keck, the founder and principal shareholder of Superior Oil Co., died and left ten percent of the outstanding shares of stock in Superior Oil Co. to the W. M. Keck Trust, a California testamentary trust, for the benefit of the W. M. Keck Foundation, a California charitable private foundation. The sole living trustee of the W. M. Keck Trust is Howard Keck, surviving son of donor W. M. Keck; Howard Keck serves also as the former chairman and current director of Superior Oil Co., and as one of the directors of the W. M. Keck Foundation. Howard Keck's responsibilities as trustee of the W. M. Keck Trust include administering the trust assets (stock in Superior OIl Co.,) and distributing income to the W. M. Keck Foundation annually to meet the minimum distribution for exempt purposes requirements imposed by I.R.C. section 4942. For these services, Howard Keck has sought California probate court approval of a $1 million fee to himself for two of the three years in which the W. M. Keck Trust has accounted to the court. Since 1980, the California Attorney General has engaged in extensive litigation and negotiations to challenge these requested fees as excessive and unreasonable.

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[5] California private foundation statistics are based on March, 1983 IRS data taken from 1979-80 IRS 990-PF data, and from the grants summary in the 1983 edition of Foundation Center Data Book, based on a survey of 1,650 large California private and community foundations (1979-80 tax returns).

[6] Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487.

Notwithstanding litigation, Howard Keck received $1.37 million in total fees for his first two years of Keck Trust administration, and has a fee request for $859,000 currently pending before the Los Angeles County probate court. Mr. Keck justifies these fees by relying on the enormous value of the trust's assets, Superior Oil Co. stock, which has ranged in fair market value between $250 and $446 million during the existence of the trust. While California's efforts through litigation and negotiation have resulted in some reduction in these trustee fees, our office is not convinced that this type of fee problem could not be resolved more efficiently through application of Federal tax law restriction against self dealing by a disqualified person and prohibitions on excessive and unnecessary payments to disqualified persons by private foundations.

Mr. Keck is a disqualified person under I.R.C. section 4941 by virtue of his family connection to the substantial donor, W. M. Keck. It has been the position of the California Attorney General throughout the litigation that Mr. Keck's requested fees are excessive and unreasonable in relation to the minimal custodial services rendered by him to the trust. We consider also that such fees are unnecessary to the accomplishment of the trust's exempt purpose, since the trust instrument (will) permits Mr. Keck as trustee full discretion to terminate the W. M. Keck Trust at any time and distribute its assets over to the related W. M. Keck Foundation, which already assumes all responsibility for distribution selection and could, efficiently and less expensively, assume Mr. Keck's custodial role as passive administrator of the Superior Oil Co. stock.

The related problem of excessive attorneys and executor's fees in reliance on state probate code fee schedules is in litigation in California at this time, also. (Est. Jean P. Getty, L.A. Sup. Ct. No. P622826; 2 Civ. No. 67351.)

We recommend that this Oversight Subcommittee inquire into the availability of existing Federal tax law enforcement tools to address cases of self dealing and conflict of interest in the exercise of discretionary trustee powers. We suggest that the Subcommittee consider amending Federal tax law on self dealing to impose guidelines or limitations on fees and administrative expenses to disqualified persons, possibly to a percentage of annual income or qualifying distributions for exempt purposes.

(2) Are conduit/flow-through private foundations, in which one private foundation makes grants to another, fostering waste, duplication and delay in the making of charitable grants? (Tax benefits allowed to donor for conduit or "flow through" private foundations (I.R.C. § 170(1)(D)(ii))

The W. M. Keck Trust and W. M. Foundation, as described in the preceding section, point out the potential for double administrative expense, inefficiency and delay in charitable private foundation administration where two related conduit private foundations are permitted to carry out one charitable exempt purpose. We suggest that the Oversight Committee reevaluate the merits of conduit private foundations and consider at a minimum, more stringent provisions for early disribution to qualified exempt organizations and guidelines or limitations on fees and administrative expenses to minimize duplication and waste of assets.

(3) Should Federal tax law require diversification of the investment assets of private foundations? (Prohibitions on jeopardizing investments (I.R.C. § 4944))

During California's charitable enforcement experience, it has been noted that minimal diversification of investment assets among private foundations appears regularly. Tax planning considerations coupled with a donor's desire to maintain family control of corporate stock appear to contribute to this situation. The W. M. Keck Trust exemplifies this arrangment, in a context where even I.R.C. section 4943 provisions for divestiture of excess business holdings of twenty percent of outstanding stock will not come into play, since the trust and disqualifies persons together hold less than twenty percent of the Superior Oil Co. stock.

We suggest that I.R.C. section 4944 provisions against jeopardizing investments be reviewed for possible amendment by addition of a provision requiring private foundation trustees and managers to take timely and reasonable steps to diversify foundation investments. At minimum, Federal tax law should alert private foundation managers to the commonly accepted principles of prudent investment management in which diversification is normally an essential component.[7]

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[7] See Lombard & Nelson "Achieving an Innovative Investment Approach While Meeting Fiduciary Prudence Requirements" Estate Planniang, May 1980; McSwain, "Prudent Diversification, Suggested Solutions for Trust Investors," 106 Trusts & Estates, p. 845, Scott on Trusts (3d Ed.) § 228, p. 1855.)

(4) Should penalty taxes on disallowed private foundation activities be assessed exclusively against foundation managers and/or disqualified persons, rather than against the foundation's charitable assets? (Automatic imposition of first level penalty taxes for breach of I.R.C. Chapter standards (I.R.C. §§ 4941–4945); abatement of first level penalties)

The William Turner Trust, cited earlier, is an example of counterproductive tax law enforcement and of duplication in enforcement effors resulting from the automatic imposition of first level penalties on private foundations. The Turner Trust was assessed $5,000 by IRS for first level penalty taxes under I.R.C. section 4945 (taxable expenditures in the form of grants made by disinterested trustees to remote relatives of the donor). The $5,000 was paid from the charitable trust assets, which came to the attention of the California Attorney General. The Attorney General brought a civil action in state court against the trustees and successfully recovered for the foundation the $5,000 fine, plus another $5,000 in legal fees which the trustees had sought to pay from the foundation's assets to their own attorneys. Considerable attorney time for discovery and litigation was required in this case, as in other similar California cases, and was allocated due to the important principle at stake rather than the monetary amounts involved.

We note from the advance agenda that the Oversight Subcommittee plans to consider modification of current Federal tax law provisions for automatic first level penalties. We support such changes, including abatement of penalties assessed against private foundation assets. Penalties should be administered to deter improper or wrongful activity by private foundation managers, not to reduce the flow or urgently needed charitable funds into the public sector.

(5) Is more flexibility needed in the divestiture requirements for excess business holdings? (Divestiture of excess business holdings exceeding twenty percent of voting stock (I.R.C. § 4943).)

The Wm. Gilmore Foundation is a California private foundation which holds excess business holdings consisting of stock in the Gilmore Steel Company. The Foundation and Gilmore Steel Co. have common directors. Under present Federal tax law, the Foundation must divest its excess business holdings within approximately 14 months or face the penalty of taxes imposed by I.R.C. section 4943. The Foundation has received a purchase offer for its stock from Gilmore Steel Co. at a price well below book value and unacceptable to the California Attorney General, who, under California Corporations Code section 5913 receives advance notice of sales of substantial assets by California charitable corporations.

The Gilmore Foundation problem reflects an unfortunate concurrence of depressed economic conditions in the steel industry, a condition of "urgency" as the time limit for avoiding penalties approaches, and a foundation without the benefit of completely disinterested trustees. During the ongoing negotiations concerning an acceptable sales price and terms, the California Attorney General has suggested as an alternative to a distress sale, a gift of the required portion of stock to a qualified exempt organization. The Foundation trustees point out that this move would further dilute the "control" value component of the Foundation's stock holdings.

We suggest that amendments to I.R.C. section 4943 be considered to impose on foundation managers a continuing duty from the time of receipt of excess business holdings to use their best efforts to divest such holdings at the best available price, and to report on their efforts in the annual foundation return (990–PF). Foundations should be required to expose their excess business holdings to the broadest possible market, particularly where sales involve potential conflicts of interest. As a disincentive to "distress sales" to disqualified persons, we suggest a new provision against unjust enrichment: if a sale is made to a disqualified person who resells at a substantial profit within a short period (i.e., five years), the disqualified person should be required to repay to the foundation a percentage of such profit.

The California Attorney General's charitable trusts staff is available to supply any supplemental case files, Registry statistics or other data required by the Oversight Committee. Please direct all such inquiries to the attention of Assistant Attorney General Carole Ritts Kornblum, 6000 State Building, San Francisco, California 94102; (415) 557–2645.

Thank you for the opportunity to share with your committee some of California's experience and concepts for improved charitable trust enforcement.

Very truly yours,

JOHN K. VAN DE KAMP, *Attorney General.*

Hanna and Morton
Los Angeles, Calif., June 29, 1983.

Re: House of Representatives Committee on Ways and Means, Subcommittee on Oversight; hearings on rules governing private foundations—statement of California attorney general, John K. Van De Kamp, and testimony by James Cordi, deputy attorney general, presented on June 27, 1983—W. M. Keck Trust

Hon. Charles B. Rangel,
Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives, Washington, D.C.

Dear Representative Rangel: This letter is to correct misstatements of fact and nondisclosure of material facts in the June 21, 1983 letter of John K. Van De Kamp to you and in the testimony of James M. Cordi, Deputy Attorney General, which testimony was presented on June 27, 1983 before the Subcommittee on Oversight.

I am a partner of the law firm of Hanna and Morton, attorneys of record for the W. M. Keck Trust. Hanna and Morton are also attorneys for the W. M. Keck Foundation, the sole beneficiary of the E. M. Keck Trust. I was present at the June 27, 1983 hearing and heard the testimony of James Cordi.

Although Mr. Van De Kamp's signature appears at the close of his letter, we are not certain the extent to which he is personally aware of the misstatements and misrepresentations contained in the letter. Please note the initials which appear after Mr. Van De Kamp's signature indicating he may not have signed the letter. However, Mr. Cordi, who has represented the Attorney General and the W. M. Keck Trust, is acutely aware of the true facts and circumstances concerning such Trust. Therefore, for the purposes of this letter, we direct our comments specifically to Mr. Cordi, although we assume Mr. Cordi carries the authority to represent the views of the Attorney General in these hearings.

Although there are several misstatements and misrepresentations contained in Mr. Van De Kamp's letter and in the testimony of Mr. Cordi, I will confine this letter to our most substantive concerns:

1. The California Attorney General negotiated, stipulated and is a party to the existing schedule for payment of Trustees' fees and Attorneys' fees, which the Attorney General now labels in his letter as "exorbitant" (page three, paragraph (2)); and, the Attorney General has misrepresented the facts concerning the payment of such Trustees' fees.

The California Attorney General, under the supervision of the Court, voluntarily negotiated, stipulated and agreed, on behalf of charity and the public, to the existing schedule for payment of Trustees' and Attorneys' fees in the W. M. Keck Trust. The California Superior Court has approved such Stipulation as "fair and reasonable." We have attached as Exhibit "A" to this letter, the Stipulation and the Court Order, thereon.

Please note that the Court has reserved jurisdiction and discretion to determine the amount of Trustees' or Attorneys' fees at any time, irrespective of the Stipulation between the Attorney General and the Trust. In fact, there is presently pending before the Court the Third Account Current wherein the Court will determine the amount of fees for calendar year 1981, and is considering the views of a third party concerning those fees.

You will also note that this Stipulation is signed by James M. Cordi, Deputy Attorney General, who testified before this Subcommittee objecting to the fees.

The Stipulation is effective beginning with the Second Account Current (1980) and for subsequent accounting periods. The agreed-upon formula is based on audited procedures for computing the average value of the corpus of the trust under Federal law (Internal Revenue Code Section 4942). The formula provides that the Trustees' and Attorneys' fees will vary in amount, up and down, as the average value of the corpus changes, compensating the Trustees (and their Attorneys) for both performance and risk, the two major elements in determining trust compensation on a "case-by-case" basis.

Also, the Trustees' fees are payable to two Co-Trustees, equally. Although one Co-Trustee is now deceased, all petitions to date for fees have been made by the two Co-Trustees (in one accounting, the deceased Co-Trustee is represented by the Executors of his estate); and the Trustees' fees allowed by the Court have been divided between those two Co-Trustees. Trustees' fees payable by Court Order after a full trial on the merits in the First Account Current (1979) prior to the Stipulation, were also divided between two Co-Trustees. These facts were misstated in Mr. Van De Kamp's letter and misstated by Mr. Cordi on the record at the June 27, 1983 hearing. Mr. Van De Kamp's letter states, in pertinent part, as follows: ". . . Howard Keck has sought California probate court approval of a $1 million fee to himself for two of the three years in which the W. M. Keck Trust has accounted to the court . . . Notwithstanding litigation, Howard Keck received $1.37 million in total fees for his first two years of Keck Trust administration, and has a fee request for $859,000 currently pending before the Los Angeles County probate court." See Van De Kamp letter, page six.

The above-quoted language is factually incorrect, grossly misleading and Mr. Cordi knows it.

Mr. Cordi represented the Attorney General, charity, and the public in the litigation in the First Account Current and in the Stipulation which applies to the Second and succeeding Accounts Current.

The correct facts with respect to Trustees' fees in the Keck Trust, are as follows:

Year:	*Fees per trustee*
1979 (and the last two weeks of 1978) per Court Order	$275,000
1980 per Stipulation with Attorney General, by James M. Cordi, Deputy Attorney General, and Court Order thereon	412,500
1981 per said Stipulation with Attorney General, Court Order Determining Fees still pending	[1] 429,454

[1] Requested.

The major purpose of the Stipulation between the Attorney General and the Trustees and their Attorneys was to eliminate time consuming and costly fees litigation, year after year—in short, to allow the Trust to devote its total energies to serving charity. The only "inefficiency and delay" referenced in Mr. Van De Kamp's letter (page seven) in administering the Trust is a result of litigation, not a result of the mere fact that there are two legal entities (the Trust and the Beneficiary Foundation) serving charity.

2. The effect of Mr. Van De Kamp's letter and of Mr. Cordi's testimony with respect to the W. M. Keck Trust is to request special interest legislation which will release the Attorney General from his obligations and commitments under the Settlement without first disclosing to the Subcommittee the true facts concerning those fees and the Settlement.

The fees dispute in the W. M. Keck Trust was the subject of extensive discovery, expert witness testimony, and the considered and well-reasoned judgment, after a full trial on the merits by a very astute and respected judge, Judge Jack Swink, known for his particular expertise in Probate Trust fee cases. Both the Attorney General and the Trust agreed to have Judge Swink hear the Keck Trust fees cases. This same judge render the trial court decision in the Estate of Jean P. Getty finding against the Attorney General and Mr. Cordi with respect to Executors' fees. The Attorney General appealed the case, and lost, See Estate of Jean Paul Getty, deceased, John K. Van De Kamp, Attorney General v. Trust Services of America, Inc., 2 Civ. No. 67351, California Court of Appeals, Second Appellate District, Division One, May 31, 1983. These facts are also ignored in Mr. Van De Kamp's letter (see page six).

The "case-by-case" determination of the reasonableness of fees has merit. Such determination, especially by a court having jurisdiction over the administration of the Trust, after full and complete discovery, provides a fair, open and impartial resolution of the disputed issues. But such an approach is totally undermined and charity damaged if any party to the proceedings refuses to honor and abide by the terms of any Settlement and Court Order which purports to end the dispute.

The California Attorney General is, in effect, asking this Subcommittee to recommend legislation which would rewrite the Settlement which Mr. Cordi signed, without prior notice to the W. M. Keck Trust or its Attorneys or to the Court which approved the Settlement. The Attorney General and Mr. Cordi should have so stated at the outset.

3. The Attorney General has misstated the Trustees' services as being "minimal custodial services" and has ignored the Investment Decision Responsibilities of the Trustees.

The Trustees entered into an agreement delegating the Trust's "minimal custodial" duties to a bank. Mr. Cordi is fully aware of this fact and has a copy of that agreement.

The Trustees' fees awarded by Judge Swink in the First Account Current and agreed to in the Stipulation with the Attorney General are based on other, far more substantive, responsibilities.

Judge Swink stated, in pertinent part, in his Order on Trustees' fees that: "* * * the testator appointed his two sons, petitioners herein, as Co-Trustees of the subject Trust because of his confidence in them; because of their respective fiduciary capacities with The Superior Oil Company . . . because of their ability to closely monitor trust-owned stock of The Superior Oil Company." Court Order, First Account Current, Paragraph 4.

And further stated that: "Petitioners [Co-Trustees] . . . were required to maneuver very carefully in order to coordinate their various positions with respect to said stock with due concern as to the fiduciary obligations of each position they occupied but were required to serve the subject trust and the beneficiaries thereof as their primary goal." Court Order, First Account Current, Paragraph 6. Brackets added.

And further stated that: "The Petitioners were required to and did continuously determine and evaluate all of the available alternatives with respect to investment of the corpus. These decisions required skill and judgment. Court Order First Account Current, Paragraph 7.

In short, the Court recognized that "a tremendous responsibility was placed on the shoulders" of the Co-Trustees. Court Order, First Account Current, Paragraph 10.

These are some of the more important factors upon which the Court awarded and ordered Trustees' fees to be paid—not upon "minimal custodial services" as set forth in Mr. Van De Kamp's letter.

CONCLUSION

A "case-by-case determination of Trustees' fees is a fair and reasonable approach.

In the matter of the W. M. Keck Trust, the Co-Trustees and their Attorneys received fees awarded by the Court after full and complete disclosure of the nature and extent of the services.

The California Attorney General, by James M. Cordi, Deputy Attorney General, fully participated in and is bound by the Stipulation and Court Order concerning those fees.

Mr. Cordi and the Attorney General should be supporting the Stipulation on Fees and citing it as an example of how fees' disputes can be resolved without repeated and damaging litigation, each side agreeing to a formula based on a well-reasoned Court Order.

Instead, Mr. Cordi, and the author of Mr. Van De Kamp's letter, have chosen to attack the Stipulation to which the Attorney General is a party, misstate facts concerning Trustees' fees, withhold relevant material information from this Subcommittee and, in the process, request the Subcommittee to recommend special purpose legislation which would serve only the self-interest of Mr. Cordi and the author of Mr. Van De Kamp's letter.

If Mr. Cordi is embarrassed by the Stipulation he negotiated and signed, he should have so stated openly and up front.

We recommend that the Subcommittee, in exercising its discretion, give favorable consideration to protecting the sanctity and finality of the "case-by-case" determination of Trustees' compensation approved by Court Order, particularly where the Attorney General has appeared on behalf of charity and the public.

Would you please make this letter a part of the hearing record.

Respectfully submitted

HANNA AND MORTON,
Attorneys for the W. M. Keck Trust.

SUPERIOR COURT OF CALIFORNIA, COUNTY OF LOS ANGELES

In the Matter of the Estate of W. M. Keck, Deceased.
Case No. P 486 194.

STIPULATION BETWEEN TRUSTEES AND ATTORNEY GENERAL RE BOTH TRUSTEES' FEES AND ATTORNEYS' FEES IN THE SECOND ACCOUNT CURRENT, AND IN ALL SUBSEQUENT ACCOUNTS CURRENT

George Deukmejian, Attorney General on behalf of the Public of the State of California, and in his capacity as supervisor of charitable trusts (hereinafter, "Attorney General"), by and through James M. Cordi, Deputy Attorney General, and W. M. Keck, Jr. and Howard B. Keck, and each of them, Trustees of the Trust for the benefit of the W. M. Keck Foundation, established under the Will of W. M. Keck, Deceased (hereinafter, "Trustees"), by and through Hanna and Morton, their attorneys of record, hereby stipulate and agree as follows:

Whereas, the First Account Current and Report of Trustees; Petition for Allowance of Trustees' and Attorneys' Fees and for Order Approving Allocation of Income and Principal of the above-mentioned Trust came on for hearing on December 2, 1980 in Department 5 of the above-mentioned Court, and was transferred to Department 58, and was heard on April 20 through April 24, 1981 before the Honorable Jack W. Swink, Judge, along with the Attorney General's Objection to First Account Current and Report of Trustees' and Petition for Allowance of Trustees' and Attorneys' Fees; and

Whereas, the Court rendered an Order allowing reasonable trustees' fees in the total amount of $550,000.00, to be paid out of trust assets, equally to W. M. Keck, Jr. and Howard B. Keck, Co-trustees; and, rendered an Order allowing reasonable attorneys' fees to Hanna and Morton in the amount of $110,000.00 and out-of-pocket disbursements, as approved; and

Whereas, the Trustees of the above Trust filed their Second Account Current and Report of Trustees; Petition for Allowance of Trustees' and Attorneys' Fees; and Petition for Abandonment of Asset which came on for hearing on August 4, 1982 in Department 5 of the above-mentioned Court, at which time the matter was set for a mandatory settlement conference in Department 5 before the Honorable Robert J. Blaylock, Judge Pro Tempore, on October 1, 1982. The Attorney General filed his Objection to Second Account Current and Report of Trustees and Petition for Allowance of Trustees' and Attorneys' Fees on August 16, 1982; and

Whereas, it is the desire of the Trustees and of the Attorney General to settle their disputes with respect to the computation and award of trustees' fees and the fees for the attorneys of record for the Trustees with respect to the Second Account Current, and with respect to all subsequent accounts current.

Now, therefore:

1. Trustees' fees for the period covered by the Second Account Current (calendar year 1980) and all periods covered by subsequent accounts current of the subject Trust shall be computed and paid out of trust assets to the Trustees so long as one or both of W. M. Keck, Jr. or Howard B. Keck is serving as Trustee (trustees' fees to be divided equally if there be two trustees), as follows:

Two numbers will be added to arrive at the total trustees' fees payable for the period covered by each account current:

First Number: An amount computed by multiplying the factor .0022 times the first Two Hundred Fifty Million Dollars ($250,000,000.00) of the average value of the corpus of the Trust for the accounting period in question.

Second Number: An amount arrived at by multiplying the factor .0014136 times the average value of the corpus in excees of the first $250,000,000.00.

The average value of the corpus will be computed in accordance with the terms and provisions of the document entitled "Computation of Average Value of Trust Corpus" which uses, for purposes of explanation, the asset values for calendar year 1980, attached as Exhibit "A" hereto, the terms and provisions of which are incorporated herein by reference.

Trustees' fees for the Second Account Current will be paid to the Trustees in the total amount of $825,000, $412,500 to each Co-trustee. For the purposes of the Second Account Current, but not subsequent accounts current, the Trustees' fees determined by applying the above formula have been rounded off to arrive at the amount of $825,000.

2. Attorneys' fees for the period covered by the Second Account Current and all ordinary attorneys' fees for all periods covered by subsequent accounts current of the subject Trust will be computed and paid out of trust assets to the attorneys of record for the Trustees, as follows: An amount computed by multiplying the factor .0004275 times the average value of the trust corpus for the accounting period in question.

The average value of the corpus will be computed in accordance with the terms and provisons of Exhibit "A" hereto, as in the case of trustees' fees.

Applying the formula set forth in this paragraph 2, attorneys' fees for the Second Account Current will be paid to Hanna and Morton in the amount of $190,000. For the purposes of the Second Account Current, but not subsequent accounts current, the attorneys' fees determined by applying the above formula have been rounded off to arrive at the amount of $190,000.

3. Trustees' fees and attorneys' fees are to be computed in all accounts current strictly in accordance with the formulae in paragraphs 1 and 2 hereinabove, irrespective of the amount of the average value of the corpus, whether said average value has increased or decreased in any amount from the average value during the period of the Second Account Current of $444,542,211.00. Payment of any costs or other out-of-pocket disbursements are subject to Court approval.

4. While this stipulation is not binding on the Court, which will reserve jurisdiction to review all fees as to reasonableness, it will preclude the Attorney General from objecting in regard to either the amount of trustees' or the amount of attor-

neys' fees prayed for and computed in accordance herewith. This stipulation will not in any way affect the fiduciary responsibilities of the Trustees or the right of the Attorney General to question, prior to Court approval of the acts of the Trustees for the period or periods in question, any breaches of fiduciary responsibility by the Trustees.

Dated: October 14, 1982.

HANNA AND MORTON
(Attorneys of Record for Trustees, W. M. Keck, Jr. and Howard B. Keck).
BELA G. LUGOSI,
JAMES PAUL LOWER.
By JAMES PAUL LOWER.

Dated: October 14, 1982.

GEORGE DEUKMEJIAN,
Attorney General
JAMES M. CORDI,
Deputy Attorney General
(Attorneys for Attorney General, State of California).
BY JAMES M. CORDI.

EXHIBIT A

COMPUTATION OF AVERAGE VALUE OF TRUST CORPUS

The following is an explanation of how to arrive at the average value of the Keck Trust corpus. For purposes of explanation, this computation uses the asset values for calendar year 1980, the year involved in the Second Account. This method of computation is in accordance with federal regulations and is approved by the Trust's auditors, Arthur Andersen & Co., to be used for the purpose of determining minimum investment return.

VALUATION OF SUPERIOR OIL COMPANY STOCK

First, determine the closing price of The Superior Oil Company stock as of the last day of the month from the Wall Street Journal's listing of securities on the New York Stock Exchange. The number of shares held on the last day of each month should be multiplied by the closing price on that day. The total for 12 months is divided by 12 to determine the average value for the year. The number of shares held in the Trust through December 29, 1980 was 2,536,050 which results in an average value of the Superior Oil Company stock held by the Trust throughout 1980 of $442,355,805. (Note: 104,000 shares were distributed to the Foundation on December 30, 1980, but for this example was not considered material.) Please see Exhibit A-1, hereto.

VALUATION OF ALL OTHER ASSETS

The above procedure was also used to determine the value of the 138 shares of Standard Oil Company of California held by the Trust, which resulted in an average value of $10,916.

The average value of Certificates of Deposit was determined by adding the value of the C.D.'s as of the first day of the month and the last day of the month and dividing the sum by 24. Two C.D.'s were held by the Trust in 1980. The average values were $1,382,230 and $200,000.

The average values of cash in the savings account and cash in the checking account were determined by adding the amounts held in those accounts as of the first day of the month and the last day of the month and dividing the sum by 24. The average value in the savings account was $45,940 and the checking account average value was $38,532.

The values of the real property held by the Trust were the fair market values at year end, determined for this year by real estate appraisals. The Pebble Beach property was valued at $400,000; the Los Angeles and Ventura County property was valued at $109,000.

The foregoing average values total $444,542,423 for 1980. Note, this figure is $212 more than the total average value of the corpus of $444,542,211 set forth in the Petition on file herein due to a refinement of the method of calculating the average value of corpus adopted by the auditors for the Trust subsequent to the filing of the Petition.

EXHIBIT A-1—CALCULATION OF AVERAGE VALUE OF THE SUPERIOR OIL COMPANY STOCK FOR 1980

Date	Closing value	Number of shares	Value of stock
Jan. 31	148.000	2,536,050	$375,335,400.00
Feb. 29	174.500	2,536,050	442,540,725.00
Mar. 31	138.750	2,536,050	351,876,937.50
Apr. 30	146.250	2,536,050	370,897,312.50
May 30	149.000	2,536,050	377,871,450.00
June 30	160.250	2,536,050	406,402,012.50
July 31	164.500	2,536,050	417,180,225.00
Aug. 29	180.500	2,536,050	457,757,025.00
Sept. 30	213.250	2,536,050	540,812,662.50
Oct. 31	185.125	2,536,050	469,486,256.25
Nov. 28	235.000	2,536,050	595,971,750.00
Dec. 31	198.000	2,536,050	502,137,900.00
Total			5,308,269,656.25
			÷12
Average value of Superior Oil Stock in 1980			442,355,804.69

SUPERIOR COURT OF THE STATE OF CALIFORNIA FOR THE COUNTY OF LOS ANGELES

In the Matter of the Estate of W. M. Keck, Deceased.
No. P 486 194.

DECREE APPROVING SECOND ACCOUNT CURRENT AND REPORT OF TRUSTEES; ALLOWING TRUSTEES' AND ATTORNEYS' FEES AND APPROVAL OF STIPULATION THEREON; AND APPROVING ABANDONMENT OF ASSET

The Second Account Current and Report of Trustees; Petition for Allowance of Trustees' and Attorneys' Fees; and Petition for Abandonment of Asset (sometimes hereinafter referred to as "Petition") came on for hearing on August 4, 1982 in Department 5. The matter was continued at the request of the objector, George Deukmejian, Attorney General of the State of California, and was transferred to Department 58 to be heard commencing after October 1, 1982. A mandatory settlement conference was held on October 1, 1982 in Department 5. The matter was then transferred back to Department 5 for hearing on October 8, 1982 and continued to October 15, 1982 at the request of Objector. The Petition and the Objection to Second Account Current and Report of Trustees and Petition for Allowance of Trustees' and Attorneys' Fees (hereinafter "Objection to Petition") came on regularly for hearing on October 15, 1982 in Department 5 of the above-entitled court before the Honorable Robert J. Blaylock, Judge Pro Tempore, sitting without a jury. W. M. Keck, Jr. and Howard B. Keck, Trustees and petitioners, appeared by their counsel Hanna and Morton by James Paul Lower and Bela G. Lugosi. George Deukmejian, Attorney General of the State of California, Objector, appeared by James M. Cordi, Deputy Attorney General.

By stipulation, which has been reviewed and approved by the court subject to the terms and provisions of paragraph 4 thereof, the Objection to Second Account was settled as to both Trustees' fees and fees for attorneys of record for the Trustees as to the Second Account and all future accounts current, and all other objections to the Petition were withdrawn by the Attorney General.

All notices of the hearing of the Petition and of the Objection to Petition have been given as required by law.

The court, having considered the stipulation between the Trustees and petitioners and the Attorney General filed herein on October 15, 1982 (hereinafter the "Stipulation") and being fully advised in the premises, finds as follows:

1. During the period covered by the Petition, the petitioners managed and administered the trust estate in accordance with law and in accordance with the terms and provisions of the trust. All investments made and assets retained in the trust during the accounting period were in conformity with and were authorized by the

terms of the trust and they have been carefully, prudently and in good faith made or retained for the purpose of serving the best interests of the trust.

2. All facts as alleged in the Petition, including its schedules and exhibits, are true and correct except allegations that the attorneys' and Trustees' fees as requested, were reasonable.

3. The settlement between the Trustees and the Attorney General as reflected in the Stipulation is fair and reasonable.

4. The amount of reasonable Trustees' fees in accordance with the Stipulation and with Section V.I. of the subject trust instrument, and the amount of reasonable attorneys' fees for Hanna and Morton in accordance with the Stipulation and with Sections II.Q. and V.K. of the subject trust instrument are as set forth in the following order and decree.

It is therefore ordered and decreed as follows:

A. The Second Account Current and Report of Trustees; Petition for Allowance of Trustees' and Attorneys' Fees; and Petition for Abandonment of Asset, including all the acts and transactions of petitioners as set forth or relating to the matters set forth in said Second Account Current and Report of Trustees is in all respects approved, confirmed, allowed and settled as rendered and reported, leaving a balance on hand of $68,502,754.70.

B. Petitioners are ordered to abandon 280 shares of Hollywood Mortgage & Finance Corporation stock as worthless.

C. The settlement between the Trustees and the Attorney General as reflected in the Stipulation is approved.

D. Reasonable Trustees' fees in accordance with Section V.I. of the subject trust instrument and pursuant to the Stipulation between the Trustees and petitioners and the Attorney General filed herein on October 15, 1982 of $825,000, divided equally so that reasonable Trustees' fees of $412,500 each, are approved, allowed and ordered paid to W. M. Keck, Jr. and Howard B. Keck for services to the trust for the period covered by said Second Account Current and Report of Trustees, less $250,000 each taken on account.

E. Reasonable attorneys' fees in accordance with Section II.Q. and V.K. of the subject trust instrument and pursuant to the Stipulation between the Trustees and petitioners and the Attorney General filed herein on October 15, 1982 of $190,000 and their disbursements in the amount of $10,983.25 are approved, allowed and ordered paid to Hanna and Morton, less $100,000 taken on account.

Dated: October 15, 1982.

S. Robert T. Blaylock, *Judge Pro Tempore.*

State of California, Department of Justice,
Los Angeles, Calif., August 2, 1983.

Re: Testimony of California attorney general on June 27, 1983 before the Subcommittee on Oversight.

Hon. Charles B. Rangel,
Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives, Washington, D.C.

Dear Representative Rangel: I am pleased to take this opportunity to respond to the June 29, 1983 letter from James P. Lower, Esq. to you, a copy of which was directed to my office. In that letter, Mr. Lower disputed the amount of trustees' fees paid by the W. M. Keck Trust, suggested that a pragmatic settlement approach by this office to repetitious litigation should preclude the California Attorney General from citing to Congress his concerns about private foundation oversight, and wrongly accused my staff of misstatements and unspecified "self interest."

To clarify any questions in the record, it is correct that out statement and testimony failed to mention that $1.37 million in trustees' fees paid for the first two years of administration of the W. M. Keck Trust were divided among Howard Keck and his now deceased brother, W. M. Keck, Jr. This apportionment of $1.37 million between related co-trustees does not convert an unreasonably high fee into one which is reasonable. The cost to charity of that fee is the same no matter how many members of Mr. Keck's family share in it. Two or more trustees are entitled to no greater a total fee than a single trustee (see Restatement of the Law of Trusts, 2d Ed., § 242(1), p. 611). A fee which would be excessive for a single trustee would be just as excessive for two. Although Mr. Lower takes pains to point out that Howard Keck received only half of the trustee fee while his co-trustee was alive, he fails to explain that for periods of trust administration after his co-trustee's death, Mr. Keck will be entitled to collect the entire fee. (That is also specified at page 3 beginning at line 4 of the stipulation attached to Mr. Lower's letter.) Nor is Mr. Lower now volunteering on Mr. Keck's behalf henceforth to accept only half of the fee which he formerly divided with his brother.

We are puzzled by Mr. Lower's effort to distract the subcommittee's attention from the essential point of the California Attorney General's statement concerning the W. M. Keck Trust, that enormous trustees' fees, totalling $1.37 million during the first two years of trust administration, were paid from charitable assets to trustees who were disqualified persons under federal tax laws governing private foundations. The fact that this office expended considerable staff attorney time in litigation and negotiation of a formula settlement over these trustees' fees does not diminish the ultimate cost to charity. In fact, these California state court legal disputes over the W. M. Keck trust fees have resulted not only in great cost to California's taxpayers, but in further "hidden" costs to the W. M. Keck Trust in the form of legal fees paid to Mr. Lower's law firm to defend the trustees. All trustees' fees and the legal fees paid to Mr. Lower's law firm are a matter of public record. Mr. Lower, who is himself defined as a disqualified person under federal tax laws with respect to the W. M. Keck Trust, received $190,000 legal fees from the W. M. Keck trust to his law firm in 1980. Future legal fees will inure to Mr. Lower's firm under the formula settlement.

Mr. Lower suggests that we failed to inform the Subcommittee of a settlement in state court regarding trustees' fees. On the contrary, our written statement to the Subcommittee mentions that we participated in "negotiations" (p. 6) and Mr. Cordi's testimony acknowledged that we entered into such a settlement. As the exhibit to Mr. Lower's letter reveals, the settlement document contains a complex formula approach for calculation of future trustees' and attorney's fees from the W. M. Keck Trust. The actual dollar amount is submitted annually to the Superior Court for its finding on reasonableness.

This settlement formula entered into before I assued office reflected a pragmatic compromise by this office to the prospect of repetitious litigation that already had consumed enormous time and resources of this office. The same problems that led our office to seek a practical resolution of the Keck litigation were the stated incentives to our presentation to this Subcommittee and our expressed hope that Federal enforcement agencies will assert their proper influence in this area. We strongly disagree with Mr. Lower's suggestion that the Attorney General's resolution of state court litigation in the W. M. Keck Trust should censor our expression of ongoing concern over one of the most extreme caes of high private foundation trustee's fees to come to our attention.

It is largely as a result of our legal disputes with the W. M. Keck Trust Trustees that we are convinced that the greater supervisory resources of the Federal government should be focused on the problem of controlling excessive fees for a trustee of a private foundation who is a disqualified person under federal tax law. Federal statutes mandate that such compensation must be not only reasonable but must also be necessary to the fulfillment of the foundation's charitable purpose. The latter limitation, that of necessity, is one which does not exist under California law. As our written statement suggests, we consider that Mr. Keck's fees may under federal law be unnecessary to the accomplishment of the trust's exempt purpose since the trust instrument (will) gives the trustee full discretion to terminate the trust at any time and distribute its assets to the related W. M. Keck Foundation. The latter already assumes all responsibility for making the ultimate charitable distributions which represent the only exempt purpose of both foundations.

We concluded that the management of the W. M. Keck Trust has been passive because the single block of stock which makes up virtually all of its assets requires no active management if one intends merely to hold it as the trustee has done in this case. Because the trust instrument indicates that the trustee is "expected" to retain that stock in the trust, because it is the largest single block of Superior Oil Company stock in existence, and impliedly the principal instrument of Howard Keck's considerable personal influence over the company's management, Mr. Keck would appear to have both the authority to hold it indefinitely and a personal interest in continuing to do so.

Mr. Lower has provided no facts to support his claim that members of my staff are motivated in this matter by some "self-interest" which he fails to specify. Nor am I aware of the existence of any such facts. On the contrary, the recommendations which we have made to your Subcommittee would serve the public interest by helping to assure that the public receives the full measure of benefit from private foundations to which it is entitled.

Very truly yours,

JOHN K. VAN DE KAMP, *Attorney General.*

Chairman RANGEL. The Chair welcomes Jonathan Silbermann.

STATEMENT OF JONATHAN J. SILBERMANN, SECTION CHIEF, NON-PROFIT ORGANIZATIONS SECTION, CHARITIES, TRUSTS AND ESTATES BUREAU, OFFICE OF THE NEW YORK STATE ATTORNEY GENERAL

Mr. SILBERMANN. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee, I would like to thank you for this opportunity to testify before the subcommittee concerning rules governing private foundations.

Approximately one-third of the Nation's foundations are based in New York State. Indeed, one study indicates that New York City foundations alone give approximately 29 percent of grants made annually in this country. The New York attorney general is charged with the responsibility of insuring that these charitable assets are administered properly. To carry out this duty, the office is given broad powers to assure proper performance by directors and others responsible for foundation conduct. Our interest and responsibility in this area of philanthropy is great.

My testimony today will describe the impact the Tax Reform Act of 1969 has had on New York State's ability to insure the proper administration of foundation assets, and discuss the integral role that act has played in the State's efforts in the area. Finally, I will address the need for greater cooperation and sharing of information between the Internal Revenue Service and the States.

Many of the major provisions of the 1969 act embody traditional common law concepts of trustee conduct and therefore parallel requirements imposed by State law. Taxes on self-dealing and transactions between disqualified persons are analogous to traditional notions of fiduciary management and prohibitions against self-inurement. The provisions with respect to the failure to distribute income embody the State law concept that it is improper to accumulate unreasonable fund balances that are essentially not used for charitable purposes.

Taxes imposed on excess business holdings relate to financial management principles requiring diversity in investment holdings. These taxes also reflect concerns with actual or potential conflicts of interest. Provisions dealing with jeopardizing investments are, in effect, a restatement of prudent investment rules imposed by State law. These principles of both Federal and State law stem from the same need to prevent abuses and to assure that public, not private, purposes are served by foundations that enjoy partial public subsidy through the tax laws.

The standards set by provisions of the 1969 Tax Reform Act have reinforced traditional New York State law concepts imposing fiduciary responsibility on foundation directors. Indeed, shortly after the passage of the 1969 act, New York incorporated the Internal Revenue Code's provisions concerning undistributed income, acts of self-dealing, excess business holdings, jeopardizing investments, and taxable expenditures in its not-for-profit corporations law. In certain instances, these provisions themselves have been used as a basis for securing additional funds for charitable purposes. For example, directors of several New York foundations have, from their personal assets, repaid to these foundations taxes assessed by the IRS on undistributed income. In other instances, the deadlines with respect to the disposition of excess business holdings have been used by the office to emphasize the need to diversify a foundation's nondiversified investment portfolio.

Further, the forms required to be filed with the Internal Revenue Service include questions that are important to determine compliance with both the 1969 act and State law. In one instance, the admission by a foundation—the Levitt Foundation—on its tax return that it had engaged in an act of self-dealing prompted a major investigation by this office and the discovery of significant improprieties.

To the extent that the act's essential provisions reflect traditional State law concepts, they should not be changed. Such a change might have unfortunate consequences on the administration of foundation assets and be perceived as an invitation to abuse.

I understand that there are those in the foundation community who argue in favor of weakening the provisions of the 1969 act with respect to excess business holdings and lengthening the time within which foundations will be permitted to dispose of their excess holdings. Of course, we recognize that an appropriate period must be allowed for the prudent disposition of excess holdings so as not to affect adversely a foundation's financial condition.

Nevertheless, it is the position of this office that any substantial change would be ill advised. The periods contained in the original act—20, 15, and 10 years—are sufficiently long to permit an orderly disposition of these assets. This office also believes that the 5-year limit for new foundation acquisitions allows a reasonable period within which to divest prudently excess holdings.

Many States flatly prohibit fiduciaries, such as foundation managers or directors, from maintaining for their foundation a nondiversified investment portfolio. While New York has not adopted such a strict rule, nondiversification is one element used to measure the propriety of directors' conduct. A violation of the excess business holding rules under Federal law, in most instances, would mean that a foundation's investment was not diversified.

This principle of requiring diversification is important. This office's experience demonstrates that nondiversification has resulted in unnecessary losses to charitable interests resulting in the millions of dollars. Further, nondiversification frequently reflects other problems that cause a foundation to maintain excess holdings of stock in one corporation. These problems often involve direct or indirect self-dealing. Such a situation can occur where a private foundation is established by a contribution of stock, and the contributor maintains an interest in the corporation and essentially controls the foundation's conduct. Thus, the foundation's significant stock ownership can serve as a means to exercise greater control over the corporation's affairs.

In addition to this kind of direct self-dealing, there is often an inherent conflict between the needs of a foundation for a regular return on investment and the needs of a particular corporation for working capital and cash flow. Thus, nondiversified holdings in one corporation may well be a poor investment vehicle because, in the usual situation, involving stock held in a closely held corporation, there is generally little stockholder demand for a steady dividend.

The 1969 act's prohibitions against excess business holdings impose fiduciary duties on foundation directors to diversify foundation investments. These provisions also eliminate the opportunity for acts of self-dealing. Any relaxation of the rules relating to excess business holdings would be seen as favoring a lower fiduciary standard.

An examination of the allegations of the New York attorney general's ongoing litigation against the Levitt Foundation makes clear the need for both State and Federal involvement in insuring that charitable assets are administered properly. The Levitt case also illustrates the kind of self-dealing that can occur through the use of a foundation's assets despite Federal prohibitions. A summary of the allegations are in my written statement. Suffice it that significant acts of self-dealing and unjust enrichment are alleged.

In sum, the 1969 act has set clear standards of conduct which are consistent with common law principles and which New York has enforced as part of its State law. To the extent that these standards reflect common law rules, this office recommends that they be retained.

THE NEED FOR GREATER SHARING OF INFORMATION AND COOPERATION BETWEEN THE IRS AND THE STATES' ATTORNEY GENERAL

Pursuant to section 6104(c) of the Internal Revenue Code, the IRS notifies appropriate State officials of the following events: First, IRS failure to recognize or continue an organization's tax-exempt status; and second, the mailing of a notice of deficiency of taxes imposed by chapter 41 or 42 of the code. Statements, records, reports, and other information relating to a determination made with respect to these two informational categories are also available at a State's request.

The information that is available has not proved particularly useful in enforcing State laws with respect to foundation management. Most of the information provided relates to a foundation's failure to furnish the Service with information necessary to grant or continue tax-exempt status. Many adverse determinations involve the failure to amend a foundation's certificate of incorporation to comply with the Service's requirements.

A significant number of the chapter 42 deficiency letters merely reflect technical violations of law, such as the failure to compute properly the excise tax. Audits are only received after a final determination has been made or some action taken.

Let me give a recent example. For the month of April 1983, the New York State attorney general received 21 notifications of IRS action from the relevant key district; 16, approximately 75 percent of these matters, involved a failure to supply information or amend a governing instrument. The three deficiency letters involved penalties of $150 or less. The remaining two adverse determinations found that the subject organizations were not entitled to 501(c)(3) tax status but rather were a social welfare organization and homeowners association, respectively.

I think it fair to say that in the past 4 years, this office has never received an IRS determination involving true self-dealing, jeopardizing investments, or excess business holdings. However, we believe that documents currently generated by the IRS but not now required to be furnished to State authorities would provide useful information which could serve as the basis for State enforcement action. These documents include audits and IRS letters advising of deficiencies in foundation operation but which do not result in the assessment of a tax or penalty.

An example of such a document involves the Service's audit of Bar-Ilan University and a resulting letter requiring correction of the way in which that university controls and disposes of gifts. The subject of the letter was a contribution made by the Levitt Foundation to Bar-Ilan. The IRS document demonstrates that the Service found that Bar-Ilan failed to control adequately the disposition of a $5 million purported contribution by the Levitt Foundation and that the transaction, and I quote, "may have resulted in improper inurement to a third party." This transaction is the subject of our recent lawsuit concerning the Levitt Foundation which I described previously.

The letter which I have just quoted from is dated March 27, 1979. It was obtained as a result of a subpena served by the Attorney General's office on Bar-Ilan. Obviously, it would have been extremely useful to have known about this information contemporaneously. Because no adverse determination was made or penalty imposed, the Service did not supply the Attorney General's office with the relevant document. There are no policy reasons to bar the sharing of this information. It simply did not fit into any of the categories enumerated in the relevant statute.

As this example shows, there is good reason for expanding the range of documents shared with State authorities. Pursuant to section 6104(d) of the code, private foundations' annual returns are already available for public inspection, and a notice to that effect must be published annually. There is no justification for denying State authorities access to related documents. The New York attorney general has the rights of members and directors of private foundations. Other attorneys general possess similar rights. These rights permit members and directors to examine such documents and provide ample basis for sharing all relevant information relating to foundation management and foundation returns.

While not providing any specific suggestions or guidelines at this time, the New York attorney general's office urges that, consistent with appropriate privacy concerns, the States be granted increased access to IRS documents such as audit reports and letters requiring correction of foundation practice, as well as other information that would aid the States in fulfilling their role in overseeing the administration of foundation assets. We are confident that such access would better enable the States to increase charitable assets and protect the beneficiaries of foundation philanthropy.

One of the 1969 act's premises in directing the sharing of information between the Federal and State governments was that an exchange of relevant information would increase the likelihood of adherence to the act's requirements. We agree. To fulfill this goal and increase compliance with the act's provisions because of the likelihood of State enforcement actions, more information must be provided on a routine basis to State authorities.

I again want to thank the subcommittee for inviting the New York attorney general and for allowing me to testify. Thank you.

[The prepared statement follows:]

STATEMENT OF JONATHAN J. SILBERMANN, SECTION CHIEF OF THE NONPROFIT ORGANIZATIONS SECTION OF THE CHARITIES, TRUSTS AND ESTATES BUREAU OF THE OFFICE OF NEW YORK STATE ATTORNEY GENERAL ROBERT ABRAMS

I. INTRODUCTION

I am the Section chief of the Non-profit Organizations Section of the New York State Attorney General's Bureau of Charities, Trusts & Estates. Thank you for this opportunity to testify before the Subcommittee on Oversight of the Ways and Means Committee, concerning the rules governing private foundations.

Approximately one-third of the nation's foundations are based in New York State. Indeed, one study indicates that New York City foundations alone give approximately 29 percent of grants made annually in this country.[1] The New York Attorney General is charged with the responsibility of insuring that these charitable assets are administered properly. To carry out this duty, the office is given broad powers to assure proper performance by directors and others responsible for foundation conduct. Our interest and responsibility in this area of philanthropy is great.

My testimony today will describe the impact the Tax Reform Act of 1969 has had on New York State's ability to ensure the proper administration of foundation assets, and discuss the integral role that Act has played in the State's efforts in the area. Finally, I will address the need for greater cooperation and sharing of information between the Internal Revenue Service and the states.

II. THE MAJOR ELEMENTS OF THE 1969 ACT ARE ANALOGOUS TO STATE LAW REQUIREMENTS

Many of the major provisions of the 1969 Act embody traditional common law concepts of trustee conduct and therefore parallel requirements imposed by state law. Taxes on self-dealing and transactions between disqualified persons are analogous to traditional notions of fiduciary management and prohibitions against self-inurement. The provisions with respect to the failure to distribute income embody the state law concept that it is improper to accumulate unreasonable fund balances that are essentially not used for charitable purposes. Taxes imposed on excess business holdings relate to financial management principles requiring diversity in investment holdings. These taxes also reflect concerns with actual or potential conflicts of interest. Provisions dealing with jeopardizing investments are, in effect, a restatement of prudent investment rules imposed by state law. These principles of both federal and and state law stem from the same need to prevent abuses and to assure that public, not private, purposes are served by foundations that enjoy partial public subsidy through the tax laws.

III. THE PROVISIONS OF THE 1969 REFORM ACT HAVE BEEN USED TO REINFORCE RELEVANT PROVISIONS OF NEW YORK STATE LAW

The standards set by provisions of the '69 Tax Reform Act have reinforced traditional New York State law concepts imposing fiduciary responsibility on foundation directors. Indeed, shortly after the passage of the '69 Act, New York incorporated the Internal Revenue Code's provisions concerning undistributed income, acts of self-dealing, excess business holdings, jeopardizing investments, and taxable expenditures in its Not-for-Profit Corporations Law. In certain instances these provisions themselves have been used as a basis for securing additional funds for charitable purposes. For example, directors of several New York foundations have from their personal assets repaid to these foundations undistributed income taxes assessed by the IRS. In other instances the deadlines with respect to the disposition of excess business holdings have been used by the office to emphasize the need to diversify a foundation's non-diversified investment portfolio.

Further, the forms required to be filed with the Internal Revenue Service include questions that are important to determine compliance with both the 1969 Act and state law. In one instance, the admission by a foundation—the Levitt Foundation—on its tax return that it had engaged in an act of self-dealing prompted a major investigation by this office and the discovery of significant improprieties.

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[1] Regional Plan News, No. 111, September, 1982, published by the Regional Plan Association.

To the extent that the Act's essential provisions reflect traditional state law concepts, they should not be changed. Such a change might have unfortunate consequences on the administration of foundation assets and be perceived as an invitation to abuse.

I understand that there are those in the foundation community who aruge in favor of weakening the provisions of the 1969 Act with respect to excess business holdings and lengthening the time within which foundations will be permitted to dispose of their excess holdings. Of course, we recognize that an appropriate period must be allowed for the prudent disposition of excess holdings so as not to affect adversely a foundation's financial condition. Nevertheless, it is the position of this office that any substantial change would be ill-advided. The periods contained in the original act—20, 15 and 10 years—are sufficiently long to permit an orderly disposition of these assets. This office also believes that the five-year limit for new foundation acquisitions allows a reasonable period within which to divest prudently excess holdings.

Many states flatly prohibit fiduciaries, such as foundation managers or directors, from maintaining for their foundation a non-diversified investment portfolio.[2] While New York has not adopted such a strict rule, non-diversification is one element used to measure the propriety of directors' conduct. A violation of the excess business holding rules under federal laws, in most instances, would mean that a foundation's investment was not diversified.

This principle of requiring diversification is important. This office's experience demonstrates that non-diversification has resulted in unnecessary losses to charitable interests resulting in the millions of dollars. Further, non-diversification frequently reflects other problems that cause a foundation to maintain excess holdings of stock in one corporation. These problems often involve direct or indirect self-dealing. Such a situation can occur where a private foundation is established by a contribution of stock, and the contributor maintains an interest in the corporation and essentially controls the foundation's conduct. Thus, the foundation's significant stock ownership can serve as a means to exercise greater control over the corporation's affairs. In addition to this kind of direct self-dealing, there is often an inherent conflict between the needs of a foundation for a regular return on investment and the needs of a particular corporation for working capital and cash flow. Thus, non-diversified holdings in one corporation may well by a poor investment vehicle because in the usual situation, involving stock held in a closely held corporation, there is generally little stockholder demand for a steady dividend.

The 1969 Act's prohibitions against excess business holdings impose fiduciary duties on foundation directors to diversify foundation investments. These provisions also eliminate the opportunity for acts of self-dealing. Any relaxation of the rules relating to excess business holdings would be seen as favoring a lower fiduciary standard.

IV. THE LEVITT FOUNDATION: A CASE STUDY

An examination of the allegations of the New York Attorney General's ongoing litigation against the Levitt Foundation makes clear the need for both state and federal involvement in ensuring that charitable assets are administered properly. The Levitt case also illustrates the kind of self-dealing that can occur through the use of a foundation's assets despite federal prohibitions. The action alleges acts of self-dealing and self-inurement. These include the following: (1) loans in the millions of dollars from the Foundation to the head of the Foundation—Mr. Levitt—and to a Delaware corporation wholly owned by him and his wife, (2) the use of Foundation assets by Mr. Levitt as collateral for a $1.75 million mortgage on his personal residence, and (3) Mr. Levitt's jeopardizing the Foundation's security interest in approximately $4 million of jewelry for personal gain. As a result of a recent investigation, this month the Attorney General commenced another lawsuit based on separate allegations that Mr. Levitt had misused the foundation's charitable assets by diverting $5 million to his own personal use through a complex scheme involving a purported contribution to Bar-Ilan University in Israel.

In sum, the 1969 Act has set clear standards of conduct which are consistent with common law principles and which New York has enforced a part of its state law. To the extent that these standards reflect common law rules, this office recommends that they be retained.

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[2] See, Bogert, Trusts & Trustees, Ch. 30, § 612 at 190, 2d edition revised (1980).

V. THE NEED FOR GREATER SHARING OF INFORMATION AND COOPERATION BETWEEN THE IRS AND THE STATES' ATTORNEYS GENERAL

Pursuant to § 6104(c) of the Internal Revenue Code, the IRS notifies appropriate state officials of the following events: (1) IRS's failure to recognize or continue an organization's tax-exempt status, and (2) the mailing of a notice of deficiency of taxes imposed by Chapter 41 or 42 of the Code. Statements, records, reports and other information relating to a determination made with respect to these two informational categories are also available at a state's request. The information that is available has not proved particularly useful in enforcing state laws with respect to foundation management. Most of the information provided relates to a foundation's failure to furnish the Service with information necessary to grant or continue tax exempt status. Many adverse determinations involve the failure to amend a foundation's certificate of incorporation to comply with the Service's requirements. A significant number of the Chapter 42 deficiency letters merely reflect technical violations of law, such as the failure to compute properly the excise tax. Audits are only received after a final determination has been made or some action taken.

Let me give a recent example. For the month of April, the New York State Attorney General received 21 notifications of IRS action from the relevant key district. Sixteen, approximately 75 percent of these matters, involved a failure to supply information or amend a governing instrument. The three deficiency letters involved penalties of $150 or less. The remaining two adverse determinations found that the subject organizations were not entitled to 501(c)(3) tax status but rather were a social welfare organization and homeowners association, respectively.

I think it fair to say that in the past four years, this office has never received an IRS determination involving true self-dealing, jeopardizing investments or excess business holdings.

However, we believe that documents currently generated by the IRS but not now required to be furnished to state authorities would provide useful information which could serve as the basis for state enforcement action. These documents include audits and IRS letters advising of deficiencies in foundation operation but which do not result in the assessment of a tax or penalty. An example of such a document involves the Service's audit of Bar-Ilan University and a resulting letter requiring correction of the way in which the University controls and disposes of gifts. The subject of the letter was a contribution made by the Levitt Foundation to Bar-Ilan. The IRS document demonstrates that the Service found that Bar-Ilan failed to control adequately the disposition of a $5 million purported contribution by the Levitt Foundation and that the transaction "may have resulted in improper inurement to a third party." This transaction is the subject of our recent lawsuit which I described previously. The letter which I have just quoted from is dated March 27, 1979. It was obtained as a result of a subpoena served by the Attorney General's office on Bar-Ilan. Obviously, it would have been extremely useful to have known about this information contemporaneously. Because no adverse determination was made or penalty imposed, the Service did not supply the Attorney General's office with the relevant document.[3] There are no policy reasons to bar the sharing of this information. It simply did not fit into any of the categories enumerated in the relevant statute.

As this example shows, there is good reason for expanding the range of documents shared with state authorities. Pursuant to § 6104(d) of the Code, private foundations' annual returns are already available for public inspection, and a notice to that effect must be published annually.[4] There is no justification for denying state authorities access to related documents. The New York Attorney General has the rights of members and directors of private foundations. Other attorneys general possess similar rights. These rights permit members and directors to examine such documents and provide ample basis for sharing all relevant information relating to foundation management and foundation returns.

While not providing any specific suggestions or guidelines at this time, this office urges that, consistent with appropriate privacy concerns, the states be granted increased access to IRS documents such as audit reports and letters requiring correction of foundation practices, as well as other information that would aid the states in fulfilling their role in overseeing the administration of foundation assets. We are confident that such access would better enable the states to increase charitable assets and protect the beneficiaries of foundation philanthropy.

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[3] The IRS letter cautioned Bar-Ilan that the misuse of contributed funds might result in suspension of advance assurance of deductibility.

[4] This contrasts sharply with the relevant provisions protecting individual and other corporate returns.

One of the 1969 Act's premises in directing the sharing of information between the federal and state governments was that an exchange of relevant information would increase the likelihood of adherence to the Act's requirements. We agree. To fulfill this goal and increase compliance with the Act's provisions because of the likelihood of state enforcement actions, more information must be provided on a routine basis to state authorities.

Chairman RANGEL. Thank you.

Are the other attorneys general having the same problem that New York appears to be having in getting information?

Mr. HAYES. As far as Illinois is concerned, yes, we do. And we would join with New York in asking that not only documents but other examination efforts be coordinated with the State offices.

Chairman RANGEL. And Mr. Cordi?

Mr. CORDI. Yes.

Chairman RANGEL. Do you have specific recommendations as to what the Service can do to enhance your ability to enforce the law?

Mr. HAYES. I am not prepared to give any specific recommendation at this time. However, I am sure the office would be happy individually or perhaps through the organization like the National Association of Attorney Generals, to come up with specific recommendations.

Chairman RANGEL. That is an excellent suggestion. I wish we had thought of it.

Would you get to work on that for me in the area of foundations to see if we can get a response, and we will too? I will ask the staff to call the National Association of Attorney Generals and see whether they can think of anything that we could do to assist them in their work which originally would have been the prime responsibility of State officials, anyway.

Have any of you looked into the question of compensation for trustees, specifically? Is there any trend there in terms of excessive salaries and benefits?

Mr. HAYES. Illinois has looked into it from time to time in examination of a foundation or organization, and on a case-by-case basis we make a determination of whether there was an excessive reimbursement. We either then try to resolve it without litigation or, if need be, resort to litigation. The instances they have found are not anything astronomical.

Chairman RANGEL. It is not the type of problem that you think would warrant any further oversight by the Service, then? I was just wondering whether you have found that to be a blatant abuse, but obviously it is just not.

Mr. CONABLE. What about compensation, too, in such things as foundation directors running around in Lear jets and so forth? Has that been a problem?

Mr. HAYES. Not to my knowledge in Illinois. We have not found anything we could say is an epidemic. There have been instances of perhaps exorbitant expenses.

Mr. CONABLE. Would you get into that sort of thing at all in auditing or oversight for a foundation?

Mr. **Hayes**. We could in Illinois, and we have in the past brought litigation, some of which is pending in the courts in Cook County dealing with self-dealing and excessive expenses by the directors of a particular foundation.

Mr. **Conable**. From New York, anything?

Mr. **Silbermann**. We don't perceive a trend. Most of the cases arise on a case-by-case basis, and many of the compensation issues depend on the level of foundation activity. Generally, we get into these issues because they are related to self-inurement or self-dealing or unjust enrichment. But essentially it really is a case-by-case analysis rather than any trend.

Mr. **Conable**. Really, the most blatant abuses are easily covered by existing law and don't require anything else, do they?

Mr. **Silbermann**. I think they are covered by State law prohibiting excessive compensation rather than by additions to Federal law.

Mr. **Conable**. Thank you.

Mr. **Cordi**. In California, we have had similar experience. We, too, operate on a case-by-case basis. I have presented one glaring example to you, but we consider it to be excessive compensation which IRS has apparently taken no action on, to our knowledge.

I would like to concur in Mr. Silbermann's comments about the flow of information from IRS. In our experience, it is little in volume and little in consequence and we are not sure exactly why.

Chairman **Rangel**. Do you have specific recommendations how that flow could be expedited?

Mr. **Cordi**. Unfortunately, I am not prepared to give specifics, but it seems to me we ought to be seeing a few more audit reports and we simply don't see many of those.

Chairman **Rangel**. When you have a problem with a foundation, would it normally be the same set of lawyers for the business that appears on behalf of the foundation?

Mr. **Cordi**. This is the situation where the foundation holds a large interest in a business corporation?

Chairman **Rangel**. Yes.

Mr. **Cordi**. They are usually astute enough to get different counsel. The question is whether they are totally unrelated.

Chairman **Rangel**. In New York?

Mr. **Silbermann**. If we perceived a conflict, we would request that independent counsel be obtained, and the situation is—in the situations I am familiar with there have been independent counsel.

Chairman **Rangel**. Is the MacArthur Foundation doing anything wrong in Illinois?

Mr. **Hayes**. We think they have been pretty good so far, and our main concern is that they could be continuing to give the opportunity to keep the type of innovative and no-develop approach to their functions that they have by not having to sell at a distressed sale.

Mr. **Conable**. I should explain to you, sir, that normally foundations don't have a serious problem with us if they are trying to divest excess business holdings. The difficulties arose when they tried to seek a permanent exemption from divestiture rather than some way of extending the period of time within which divestiture is required because of problems of the marketplace or the state of the economy or specific problems affecting those excess business holdings.

But one of the purposes for this hearing is to consider the whole issue of divestiture which has been troublesome in that it constantly is coming up with respect to specific foundations. We don't really have any guidelines for it nor have we reconsidered since 1969 whether the whole purpose of divestiture has served its purpose or whether it could be better served in some other way.

But the MacArthur Foundation, as I understand, is not seeking permanent exemption; they are seeking an extension so they can get their full value out of the excess business holdings that they have to divest.

Mr. HAYES. Attorney General Hartigan's position is that the 5-year limit is fine as long as there is the provision for the flexibility if there needs to be an extension because of concerns beyond the control of the foundation, such as market conditions. That is the position that we are advocating today.

Chairman RANGEL. Mr. Thomas?

Mr. THOMAS. Thank you, Mr. Chairman.

The Under Secretary of the Treasury's testimony indicated that Treasury would not oppose a 5-year extension.

Does that seem to be a reasonable time, or do you think it would make more sense if Congress gave some discretionary abilities on the case-by-case basis?

Mr. HAYES. Our feeling is the 5-year extension is fine. It is better than it is now. We would prefer, however, a discretionary extension of time. Our position would be that with a set number such as 5 years, you might wind up with the same problem, just another deadline.

If there are good faith efforts being made, but because of depressed markets or other conditions beyond the control of the foundation, we believe the Secretary should have that discretion.

Mr. THOMAS. In some of your testimony, Mr. Cordi, you indicated problems with the Gilmore Foundation.

Was that a market condition? Did they make a good faith effort to sell the shares? Would an extension of time be appropriate in this case to allow them to try to find someone who would purchase them?

Mr. CORDI. That is an ongoing situation and it would appear that the discretionary extension of time would be the preferable way to handle the situation.

I think one thing we would like to see in connection with exercising the discretion is that the Secretary of the Treasury consult with the State attorney general that is particularly concerned with the particular foundation at hand. I don't know that the Secretary has made a practice of doing that in the past.

Mr. THOMAS. On the fee situation, Illinois and New York indicated it was a case-by-case basis. Is that true in California, as well?

Mr. CORDI. Yes.

Mr. THOMAS. If there are excess fees, you go to court?

Mr. CORDI. Yes; we do.

Mr. THOMAS. In the example you gave, you indicated that the Attorney General has engaged in extensive litigation and negotiations to challenge; notwithstanding the litigation, fees were received.

What does that mean? Did you lose in court, or has it not been finalized?

Mr. CORDI. What it means is we got a result in court that was less favorable than we had hoped for and we also negotiated for a settlement because of many reasons, not the least of which is that this sort of litigation is very time-consuming on our limited resources.

Mr. THOMAS. What was the result of the court findings on the fee amounts? They were obviously not excessive.

Mr. CORDI. The court reduced the fee in the first year to $550,000. In the second year, it was over $800,000. And the third year fee request pending before the court is now, I think, $859,000.

Mr. THOMAS. Were they flat amounts or percentages?

Mr. CORDI. Well, they were flat amounts as the court made its determination. There was a settlement entered into that involved percentages.

Mr. THOMAS. In the currently pending $859,000, that total amount goes to one individual?

Mr. CORDI. Excuse me?

Mr. THOMAS. Does the $859,000 that is currently pending go to one individual, Howard Keck?

Mr. CORDI. No, one-half goes to the estate of coexecution W. M. Kech, Jr., who is now deceased.

Mr. THOMAS. That doesn't involve legal fees or anything like that?

Mr. CORDI. No. The legal fees are over and above that.

Mr. THOMAS. Then you talked about the diversification. We have had a number of foundations, at least I have, visit me with difficulties that they have in the diversification issue. One of them I thought interesting was if they followed the law they would be in large part doing a disservice to the foundation in raising money, because the stock of the corporation that they held was really about the best place to put their money.

You indicated in again the same example that the tax planning considerations coupled with the donor's desire to maintain control of the family stock appeared to contribute to the situation.

Do you know what happened to the stock in that timeframe?

Mr. CORDI. Well——

Mr. THOMAS. That is, Superior Oil stock.

Mr. CORDI. The Superior Oil stock went from $250 million in early 1979, I believe, to something over $440 million. Now, it has come down a bit.

Mr. THOMAS. That isn't necessarily a bad decision not to diversify if you can double your assets of the foundation by not diversifying?

Mr. CORDI. That is correct. However, it is my observation that the stock market giveth and the stock market taketh away.

Mr. THOMAS. But as long as it is giving, it is a good idea not to diversify; if it starts taking away, you can always——

Mr. CORDI. It is also our observation that the man does not exist who knows the exact time when the stock market will stop giving and start taking away. For that reason——

Mr. THOMAS. Don't we pay people to do that?

Mr. CONABLE. Will the gentleman yield?

Mr. Cordi. The people paid to do that believe in diversification and practice it. That is the case with almost all types of institutional investment funds.

Mr. Conable. I am sure the gentleman would not extend his position to using foundation money to bet on a horse just because the horse won.

Mr. Thomas. Depends on which horse.

Mr. Conable. Well, I think he——

Mr. Thomas. After the fact, decisions look good, of course.

Mr. Conable. I think it is a rather generous interpretation of fiduciary obligations.

Mr. Thomas. You didn't tell me how many horses were in the race. Perhaps there is only one horse—that may be the situation with some stocks. I am amazed at the variety, the diversity of interest in problems that various foundations have based on the various mixes. It is hard for me to see an absolute rule working in every case.

What I am talking about is—I know it is impossible but some consideration within the law needs to be considered for those with particular circumstances or practices which most everyone would agree are prudent and not imprudent. Obviously, people would disagree.

Mr. Cordi. If I may further observe, that sort of consideration does need to be given on a case-by-case basis, and there are many cases where diversification is very difficult for a variety of reasons, not the least of which the stock may be restricted from being sold on the public stock exchanges.

Mr. Conable. I don't wish to carry the discussion too far, but, of course, you can overdo the business of case by case, also. The Federal Government should have some pattern which generally tends to work toward some practice. That is what fiduciary responsibility generally involves—some sort of pattern that discourages having to deal with each and every internal decisionmaking process for each individual trustee.

Mr. Thomas. I know when I am getting in over my head with the ranking member, and I will yield back.

Chairman **Rangel.** Mr. Conable.

Mr. Conable. Oh, heavens, no. I have no questions.

Chairman **Rangel.** I assume all the attorney generals are cooperating with IRS; when they find something wrong, they report it to the Service. And this is a two-way street that they are seeking in terms of cooperation.

Mr. Hayes. I believe we are.

Mr. Silbermann. Yes, Congressman. They, in fact, generally quickly contact us when they have wind of a case brewing.

Chairman **Rangel.** Sorry.

Mr. Silbermann. I say we do cooperate and they generally contact us quickly when they are aware of any action that is pending.

Chairman **Rangel.** I see.

I was asking whether or not you volunteer information to the Service when you are going to investigate, you know, to ask for cooperation from IRS in a particular case?

Mr. Silbermann. There have been cases where we have requested information from the Service. Generally——

Chairman RANGEL. Do you give information to the Service of possible violations?

Mr. SILBERMANN. If they request such information. As my testimony indicated, many violations of Federal law also involve violations of State law, and my office takes action. We don't—it is a rare situation when it is merely a violation of Federal law.

Chairman RANGEL. Well, the record will remain open for any recommendations that your offices may have to improve the Federal law.

We thank you for your testimony.

Our next witness is James Joseph, president and chief executive officer of the Council on Foundations.

The council was founded in 1949 and incorporated in 1957 and has as its members including 1,000 independent foundations, community foundations, and company-sponsored foundations. This membership has contributed more than $1½ billion to various charitable organizations in 1982, and we thank Mr. Joseph for agreeing to testify before the committee today.

STATEMENT OF JAMES A. JOSEPH, PRESIDENT AND CHIEF EXECUTIVE OFFICER, COUNCIL ON FOUNDATIONS, ACCOMPANIED BY THOMAS TROYER, COUNSEL

Mr. JOSEPH. Thank you, Mr. Chairman.

With me is Mr. Thomas Troyer, legal counsel for the council and member of the firm of Caplan & Drysdale.

In the next couple days and up to this point, Mr. Chairman, you have heard and will continue to hear a number of things that are rather abstract and legalistic. You will be pleased to know that I will summarize a few concerns that I think should be highlighted at this point and submit the rest of my testimony for the record.

Chairman RANGEL. Without objection.

Mr. JOSEPH. I think it is important in these hearings to begin to put some flesh and blood on foundation grants rather than simply dealing with them in the abstract and with strictly legal issues that have to surface during these hearings.

The first thing I would like to do is to say a word about the confusion on the data. As I listened to the IRS representatives this morning and as I have talked with them on a number of occasions, there tends to be some confusion about how many foundations there are and whether or not foundations are increasing in number or declining in number. I would like to say a word first to that point.

The Internal Revenue Service uses a figure of 33,000 to refer to foundations. This higher figure includes organizations reclassified as private foundations for failing to attract the minimum public support required to maintain their status as a public charity. These are often called "burned out" public charities and they are not grantmaking foundations. Let me give you an example.

In a recent issue of Internal Revenue Bulletin, April 19, 1983, the IRS published a list of 137 former public charities which are now classified as private foundations. Included on that list were such organizations as the Evangelist Motorcycle & Prison Ministry, the

Friends of Eun Kwang Won, the All Seasons Riding Association, Prometheus Ukranian-American Male Chorus & Operation Bliss.

The point is, Mr. Chairman, that one should use workable data. I like to refer to the information that one gets from the Foundation Center which, in its "1982 Data Book on Private Foundations," reported that for the period covered there were 22,535 private foundations on record, with assets of $41.6 billion, making grants in excess of $2.8 billion. Roughly, these grants were directed to the following categories of needs: 32.4 percent went to social welfare; 20.2 percent went for education; 17.4 percent went for cultural activities; 16.7 percent went for health; 5.8 percent for social sciences; 5.7 percent for science; and 1.8 percent for religion.

I have already said I am concerned that you not lose sight of how foundation grants take on flesh and blood in local communities. So I want to say that I have been personally heartened to see the many ways in which foundations have responded to the human needs brought on by a prolonged economic recession and reductions in Federal expenditures for domestic programs.

I am certain that this subcommittee is as pleased as I am to know that emergency loan and grant funds have been established by foundations around the country, almost half of which have been initiated in the past 2 years to assist the growing number of new poor. In your own district, for example, Mr. Chairman, young black teenage mothers are receiving the personal encouragement and support needed to complete their high school education and to acquire the skills that will allow them to support themselves through a half-million dollar grant to the coalition of a hundred black women awarded by the Commonwealth Fund.

I can cite a number of examples, but in the next few days you will hear from foundation executives and grantees about how the foundations have helped to house the homeless, how they have helped to heal the sick and how they have helped to feed those who are hungry. But I would be remiss in my responsibility to this subcommittee if I did not point out that despite these extraordinary contributions by foundations to the public welfare, it is far beyond their limits to fill the gap created by recent cutbacks in Federal funds.

When we look at the role played by private foundations in the last century, it is easy to forget that they account for only 5.2 percent of giving in the United States today. It is easy to forget that private foundation holdings are dwarfed by the $794 billion in assets held by public and private pension plans. It is easy to forget that the total assets of private foundations are only one-third of the annual budget of the Department of Health and Human Services.

The simple fact, then, Mr. Chairman, is that in any comparison of foundation philanthropy to individual contributions or to the budget of Government agencies, foundations are Davids to Goliaths. But as that analogy reminds us, small assets carefully and cautiously directed can produce extraordinary results.

I would submit to this subcommittee that this is the prime significance of foundations. The telling thing about their work is that they are often more searching and more systematic and have a longer eye to what the future is than giving of individuals tends to be. They are more flexible, more venturesome, less bureaucratical·

ly constrained, more adaptable to newly emerging needs, more so than governmental appropriations and agencies can be.

So the bottom line, Mr. Chairman, is that private foundations, devoting time and care to the choices that confront them, are in a position to use their dollars in such a way as to insure maximum impact. They are concerned about and often support traditional charities, but their most notable contributions to the quality of American life have frequently come when they have had the audacity to be daring.

Finally, Mr. Chairman, in responding to your concern about foundation experience under the 1969 Tax Reform Act, we would submit to you that for the most part the rules are working well and serving the public good intended. However, we do believe that the 1969 act could stand a few adjustments in areas which have been described in detail in my written testimony. They are included in H.R. 3043, the Conable-Shannon bill, which seeks to remove impediments to effective foundation philanthropy, and the council strongly endorses that bill.

One other point before I conclude my summary, Mr. Chairman. There has been some concern about whether or not there is actually a decline in the birth rate of foundations. There is clear consensus among experienced foundation officials that certain restrictions that I have referred to as impediments have severely affected formation of new foundations.

The creation of foundations with assets of over $1 million dropped sharply after 1969; 759 were started in the 1960's, and only 255 in the 1970's. But, unfortunately, these figures tell only part of the story.

As a percentage of gross national product, contributions to private foundations dropped by 50 percent from 1969 to 1981. In addition, Mr. Chairman, the total assets of private foundations, when adjusted for inflation, fell by 25 percent from 1969 to 1981.

For the last 7 years, foundation giving has increased over 60 percent in current dollars while declining nearly 8 percent in constant dollars. This is from Treasury and IRS figures. So I am confused about why they don't feel they have data to substantiate the fact there has been a decline in the birth rate of foundations.

This concludes my oral testimony, except for this final thought: I hope when these hearings are over and the subcommittee sits down to write its report, that you will use language as strong as that used by Treasury in 1965 to unequivocally affirm the value of private foundations in developing our democracy and sustaining our social order.

Thank you very much. I will be pleased to answer questions.

[The prepared statement follows:]

STATEMENT OF JAMES A. JOSEPH, PRESIDENT, COUNCIL ON FOUNDATIONS

MR. CHAIRMAN, Members of the Subcommittee, my name is James A. Joseph, and I am President of the Council on Foundations. With me is Mr. Thomas A. Troyer, our legal counsel. We are very pleased to have this opportunity to testify as you begin a comprehensive review of the role of private foundations in American philanthropy. We are proud of the contributions made by private foundations and the improvements that have been accomplished since the Tax Reform Act of 1969. It is our hope that these hearings will give Congress a better understanding of our efforts.

Organized in 1949 to promote responsible and effective grantmaking, the Council on Foundations shares with the Congress a desire to ensure that the public interest is well-served. We now have within our membership 940 organizations including 610 private independent foundations, 160 community foundations, 100 corporate foundations, 40 corporate donors without foundations, and 20 public charities with substantial grantmaking programs. Council members, presently hold over 50 percent of all foundation assets in the country.

In addition to our work in government relations, the Council provides numerous services to its members and the public including direct technical assistance, professional development training, and a wide variety of publications.

I. HISTORICAL ACCOMPLISHMENTS AND PRESENT ACTIVITY

I am mindful, Mr. Chairman, of the fact that most members of your Subcommittee were not part of the Congress that reviewed private foundations in 1969. And since it is in part the purpose of these hearings to build a better understanding of our institutions, I would like to give you an idea of the important contributions foundations have made to our society. Much will be said in these hearings about administrative difficulties, tax code restrictions, and other more technical issues. In this process, I am concerned that you not lose sight of the end product, the purpose for which private foundations exist.

It is fitting, therefore, to take a brief inventory and remind ourselves of the contributions initiated by American foundations over the past many years. Even a limited glimpse of this history reveals such landmarks as:

- Early assistance to Dr. Jonas Salk's polio-vaccine research
- Foundation-sponsored research instrumental in greatly reducing or eliminating other international diseases such as typhoid and yellow fevers, malaria and tuberculosis
- Grants to sociologist Gunnar Myrdal which enabled him to complete research for publication of An American Dilemma, which shocked the nation into awareness of the unequal status suffered by its black citizens
- Development of a network of free public libraries now in use in cities across the United States and Canada
- Foundation support for the research base leading to our present understanding of DNA. This cracking of the "genetic code" mechanism that shapes all plant and animal cells has been called "the single most significant advance in biology in the 20th Century"

- Foundation backing for the birth of public television and the use of television as a teaching tool. More specifically, foundations have been instrumental in supporting the Children's Television Workshop which produces Sesame Street, the highly successful program for preschool children now seen in 50 countries.

To complement these earlier examples, you will hear from several grantees during these hearings who will give you current illustrations of the work foundations are sponsoring today. With each passing year, new needs and problems come to the forefront of concern. The private foundation, with its ability to respond rapidly and with flexibility, is uniquely suited to react to emerging needs. Let me share with you just three such examples of recent grant awards.

Shortage of Math and Science Teachers

The AMOCO Foundation recently announced a grant to the Chicago Public School System to provide educational enrichment for 80 math and science teachers from the 7th and 8th grades. The teachers, chosen for their motivation, experience and leadership ability, will take 16 extra semester-hours in the summers and evenings to expand their teaching skills, and ultimately to pass them on to their peers. The improved training of these teachers is expected to qualify more students for participation in the Principal's Scholars Program (PSP) which is also funded by AMOCO. PSP currently has 1800 participating high school students in Chicago, and is designed to increase the number of minority college graduates in engineering and science.

The New Poor

Approximately 20 emergency loan and grant funds have been established by foundations around the country. Almost half of them have been initiated in the past two years in response to the cutbacks in governmental funding and the growing number of "new poor". One such example is the Basic Human Needs Fund established by a grant of $1.5 million from the William Penn Foundation to provide money to nonprofit organizations to help meet the needs of Delaware Valley residents in Pennsylvania and New Jersey. The grants are made for short-term emergency assistance to the poor for food, clothing, fuel, shelter, and health care. In its first four months of operation in 1982, grants of $750,000 had been made to 78 nonprofits to aid 20,000 families.

Teenage Pregnancy

For several years, numerous foundations have become deeply involved in the critical issue of teenage pregnancy. As one example, the C.S. Mott Foundation has granted over $2.3 million for projects designed to reduce the negative effects of teenaged childbearing. Because current non-foundation funds focus primarily on pregnancy prevention, the Mott Foundation has shifted it emphasis to ameliorating the negative consequences of teenage pregnancy once it has occurred, and the mother has opted for delivery.

II. PRIVATE FOUNDATIONS: A WORKING DEFINITION

Mr. Chairman, when these hearings draw to a close near the end of this week, I hope it will be clear to you that there exists today an immense variety of private foundations. More importantly, I hope you will see that this diversity is one of our most valued assets. I am happy to report to you that despite the strict limitations and definitions of the Tax Reform Act of 1969, private foundations today continue to play a vital and active role in American philanthropy. Based on information provided by the Foundation Center in 1982, there are 22,535 private foundations on record with assets of $41.6 billion making grants in excess of $2.8 billion (a more detailed analysis is provided in our Appendix).*

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* Source: Foundations Today 1982. The Foundation Center in compiling this widely accepted data on private foundatons must rely in large part on tax returns submitted to IRS. Since the returns for a given year are due four and a half months after the close of the tax year, and because IRS processing time involves additional delay, the most current data on foundations is usually two years old.

Although the 1983 version of Foundations Today is not yet published, the Center indicates that it will note 22,088 private foundations with $48.17 billion in assets, making grants of $3.4 billion. For the sake of consistency and appropriate data comparisons, our testimony will cite numbers from Foundations Today 1982 unless a separate source is identified.

It should also be noted that the General Accounting Office has identified the total number of private foundations as approximately 28,000. This higher figure includes approximately 6,000 organizations that are reclassified as private foundations for failing to attract the minimum public support required to maintain status as a public charity. These "burned out" public charities are not grantmaking foundations. For example, in a recent issue of the Internal Revenue Bulletin (April 19, 1983), the IRS published a list of 137 "former public charities" now classified as private foundations. Included on that list are such organizations as: the Evangelist Motorcycle and Prison Ministry, Friends of Eun Kwang Won, All Seasons Riding Association, Prometheus Ukranian-American Male Chorus of Philadelphia, and Operation Bliss, Inc.

Despite the fact that our coat has many colors, Mr. Chairman, we should, nonetheless, suggest to you a working definition before continuing with our presentation. It is generally understood that a "private foundation" is a nongovernmental, nonprofit organization with its own funds, managed by its own trustees or directors, which serves to maintain or aid charitable, educational, religious, or other activities serving the public good. Unlike most public charities, private foundations are usually given an endowment of cash or securities by a donor who may be an individual, a family, or a corporation. This endowment is invested and the proceeds are used to make charitable grants or to operate charitable programs. Some donors, especially those who set up small foundations, continue to make donations to the foundation during their lifetime, and then leave the foundation a sizable bequest in their wills. Other donors make a single large gift either before or after death.

Comparison with Public Charity

Public charities on the other hand generally obtain their support through fundraising appeals to the general public. In addition to their "public" source of funds, public charities are different from private foundations in other ways. When the 1969 Tax Reform Act provided the first legal definition of private foundations, it established a comprehensive list of restrictions under which all private foundations must operate. The 1969 Act also imposed a much more comprehensive and detailed set of public reporting requirements on private foundations. By comparison, a public charity — deriving its funds from public sources — is not subject to the same limitations on its activities, nor is it required to report its activities in as great detail to the Internal Revenue Service (IRS).

While the definition I have just provided describes the normal private independent foundation, there are variations on this theme that deserve mention and understanding. The Council includes within its membership all of the following types of foundation:

- The *operating foundation,* while similar to the private independent foundation in most respects, does not usually make grants, but instead utilizes its endowment income to conduct research or run its own direct service program.
- The *company-sponsored foundation* is closely tied to its sponsoring corporation. While some endowment income may be available, the bulk of most annual funding comes usually from the charitable contributions of the company.
- The *community foundation* is legally a public charity and not a private foundation, and therefore relies on the general public for much of its support. Most community foundations seek to build large endowments, frequently have public officials appointed to their governing boards, and generally limit their grantmaking to the local community from which they take their name.

With these definitions in mind then, I would like to spend a few moments discussing what makes us different.

III. THE UNIQUE ROLE OF PRIVATE FOUNDATIONS

Eighteen years ago, Mr. Chairman, the Treasury Department published a landmark report on private foundations. Following on the heels of earlier Congressional investigations, this 1965 report systematically reviewed the criticisms of foundations and served as the major study leading to the hearings of 1969, and the resulting Tax Reform Act which strictly limited foundation activity.

Despite the criticisms contained in that report, it is significant to point out that the Treasury Department also found great value in private foundations, both historically and for the future. Here in part is what Treasury said:

> "Private philanthropic organizations can possess important characteristics which modern government necessarily lacks. They may be many-centered, free of administrative superstructure, subject to the readily exercised control of individuals with widely diversified views and interests. Such characteristics give these organizations great opportunity to initiate thought and action, to experiment with new and untried ventures, to dissent from prevailing attitudes, and to act quickly and flexibly. Precisely because they can be initiated and controlled by a single person or a small group, they may evoke great intensity of interest and dedication of energy. These values, in themselves, justify the tax exemptions and deductions which the law provides for philanthropic activity.
>
> Private foundations play a significant part in the work of philanthropy. While the foundation is a relatively modern development, its predecessor, the trust, has ancient vintage. Like its antecedent, the foundation permits a donor to commit to special uses the funds which he gives to charity. Rather than being compelled to choose among the existing operating organizations he can create a new fund, with its own areas of interest and emphasis. His foundation may encourage existing operating organizations to develop in new directions, or it may lead to the formation of new organizations. Even if it does neither, it reflects the bents, the concerns, and the experience of its creator; and it thereby increases the diversity of charitable works. In these ways, foundations have enriched and strengthened the pluralism of our social order."

During your hearings this week, the Subcommittee will hear directly from several foundations and their grantees. They embody the diversity inherent within philanthropy and exemplify the unique and valuable role foundations play in American life. Here are two additional examples which express the scope and significance of the diversity we share.

- In response to the budget cutbacks and rising medical costs, the Commonwealth Fund recently awarded grants to a unique experimental consortium of eight teaching hospitals and several neighborhood health centers in the greater Boston area. Called the Commonwealth Health Care Corporation, it will contract with the Commonwealth of Massachusetts to provide all Medicaid-financed services to 75,000 women and children for a predetermined, annual, all-inclusive fee, thus containing costs without reducing coverage.
- Project CARE (Chemical Abuse Reduced by Education) is a successful program to reduce alcohol and other drug use, abuse, and dependency among school-age children. Operating in 64 public school districts in five Northeastern Ohio counties, and funded by several foundations (The Cleveland Foundation, the George Gund Foundation, the Martha Jenning Foundation, and the Kaiser Permanente Foundation), this program has trained parents, teachers, counselors, administrators and staff in the intervention, treatment, and rehabiliation of students affected by drug or chemical abuse.

> Over 1,200 adolescents have been sent to in-patient or out-patient treatment programs, and over 1,500 students were placed in extensive in-school and out-of-school counseling programs. At a time when schools are struggling with dwindling resources, such an innovative and comprehensive approach to this serious problem would never have started without the support of Foundations.

These examples emphasize the unique nature of private foundations. Via the endowment mechanism, a donor can continue the ability of a private foundation to respond to emerging (and emergency) needs for years to come. The funds are not expended in one lump sum, nor locked into an operating budget that constantly needs refilling. The foundation can use this uncommitted annual income to help organizations meet new challenges in new ways, ways that could never be tried if the grantee had to rely on its own operating budget. By choosing a private foundation, the donor is given the opportunity to make a substantial impact over time in an area too complex for quick solutions.

Grants from private foundations made in an independent, and unfettered atmosphere provide an unusual and valuable source of inspiration and creativity. Once again, the Treasury Report of 1965 said it well:

> "Private foundations have also preserved fluidity and provided impetus for change within the structure of American philanthropy. Operating charitable organizations tend to establish and work within defined patterns. The areas of their

> concern become fixed, their goals set, their major efforts directed to the improvement of efficiency and effectiveness within an accepted framework. Their funds are typically consigned to definite — and growing — budgets. The assets of private foundations, on the other hand, are frequently free of commitment to specific operating programs or projects; and that freedom permits foundations relative ease in the shift of their focus of interest and their financial support from one charitable area to another. New ventures can be assisted, new areas explored, new concepts developed, new causes advanced. Because of its unique flexibility, then, the private foundation can constitute a powerful instrument for evolution, growth, and improvement in the shape and direction of charity."

Before leaving this point, Mr. Chairman, I believe it is important to stress that foundations are also extremely concerned with meeting the continuing need of their communities. Accordingly, many foundations direct their giving to more established institutions. They support the good works of the Red Cross, the YMCA, the Girl Scouts, or their local churches, schools, and universities. In fact, Mr. Chairman, many foundations do both: support the traditional institutions of their community, and provide an increasing flow of venture capital for new causes and new areas of concern.

IV. THE LIMITATIONS OF PRIVATE FOUNDATIONS

Our presentation to this Subcommittee would be incomplete if we did not say a word or two about the limitations that foundations face. While we are proud of the many accomplishments we have made and the success stories we have supported, we are very mindful as well that our efforts are only a small part of the total private sector.

When viewed in the context of total annual charitable giving, private foundations contribute 5.2 percent of all gifts made. The most recent publication of Giving U.S.A. prepared by the American

Association of Fund-Raising Counsel provides the following breakdown for 1982:

	Contributions (in billions)	Percent of Total
Individuals	$48.69	80.7%
Bequests	5.45	9.0%
Private Foundations	3.15	5.2%
Corporations (including corporate foundations)	3.10	5.1%

Private foundation holdings are dwarfed by the $794 billion in assets held by public and private pension plans. Foundation assets total less than one year of charitable giving by individuals, and are only one third of the annual budget of the Department of Health and Human Services.

More specifically, it is far beyond the limits of private foundations to fill the gap created by recent cutbacks in Federal funding (estimated at over $107 billion in the years 1982-86).* That is not to say that private foundations have ignored these new developments. On the contrary, you will hear of several representative efforts to respond to these new challenges. In fact, budget cutbacks have been the very focus of many policy considerations of foundations for some time now. But the very simple fact remains that private foundations cannot replace government services. To even attempt such a feat would put us out of business very quickly.

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*Lester M. Salamon, The New Federalism, The Federal Budget and the Nonprofit Sector, April 14, 1983. This figure represents enacted and proposed changes in Federal spending in fields where nonprofit organizations are active.

V. COUNCIL SUPPORT FOR IMPROVED PUBLIC COMMUNICATION

Mr. Chairman, before turning to a discussion of the 1969 Tax Reform Act, I would call your attention to a subject high on our list of priorities, namely the stimulation of broader public accountability on the part of all foundations. In 1981, the Council on Foundations adopted a Recommended Statement of Principles and Practices which states in part:

"Beyond the filing of forms required by government, grantmakers should consider possible ways of informing the public concerning their stewardship through publication and distribution of periodic reports, preferably annual reports, possibly supplemented by newsletters, reports to the Foundation Center, and the use of other communications channels."

Over the past two years, the Council has taken several steps to support increased public reporting; for example:

- Through direct contact to members and non-members, the Council has encouraged foundations to consider publishing annual reports and descriptive brochures outlining their operations.
- To further this effort, we have designed an inexpensive annual report format available as a model to foundations.
- Often in collaboration with Regional Associations, the Council has presented workshops to show foundation staff how to provide a more comprehensive spectrum of public communication.
- In addition, we continue to work closely with the Internal Revenue Service to suggest ways to improve the Form 990-PF,

the publicly available tax return of private foundations, so that the information provided is more understandable, relevant, and complete.

The actions we have outlined here only serve to complement the most extensive and comprehensive public communication system provided by the Foundation Center through their offices and their cooperating libraries in every state.*

VI. THE 1969 TAX REFORM ACT: 14 YEARS LATER

In 1969 the Congress determined that the primary safeguard against foundation misconduct should be comprehensive legal restrictions actively enforced by the Internal Revenue Service. Accordingly, Congress enacted a regulatory framework governing virtually every major aspect of foundation activity. These restrictions include a requirement that all foundations pay out each year at least 5 percent of their asset value for their charitable purposes. Congress also adopted strict prohibitions on many activities, including:

- o Self-dealing: direct and indirect transactions between foundations and their "disqualified persons" (including foundation managers, substantial contributors and their family members) are not permitted. Examples of such transactions are the sale or exchange of property, the lending of money, or the extension of credit.

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* A summary of the public information and services made available by the Foundation Center is added in our Appendix.

- Excess business holdings: generally a private foundation together with its disqualified persons may not hold more than a limited percentage (usually 20%) of the voting stock of a business corporation.
- Jeopardy investments: foundations may not invest funds in any way that would jeopardize the carrying out of its exempt purpose.
- Grants to non-charities: grants to organizations not officially recognized as charitable institutions are not permitted without performing detailed record-keeping requirements including reporting such grants to the Internal Revenue Service. These requirements are commonly referred to as "exercising expenditure responsibility."
- Other prohibited expenditures: very stringent restrictions are imposed on grants or expenditures for lobbying, influencing elections, carrying on voter registration drives, or making grants to individuals for study or travel.

To support these prohibitions, Congress added a series of penalty taxes that could be levied against both the foundation and its managers when violations occurred. To aid in the enforcement of these new requirements, Congress also established an excise tax (now 2 percent of foundations' net investment income) to pay for the more extensive auditing and regulatory supervision that the IRS would be required to perform.

In short, there now exists a comprehensive legal mechanism ready to be used to remove any abuses should they occur. The Council fully supports the fundamental structure of these rules, and their thorough enforcement by the IRS.

In summing up the years of experience under the 1969 Act, Mr. Chairman, we would submit to you that -- for the most part -- the rules are working well, and have proven to be beneficial. Although they were initially greeted by private foundations with great dismay, we have learned not only to live with them, but to view their benefits as helpful in keeping the field free from those whose motives may not be primarily charitable.

However, we do believe that the 1969 Act could stand some adjustments in several areas. Of more importance, we believe the Act has had one very serious and troubling effect: it has greatly reduced the growth rate of new foundations. We believe this retarded growth rate is directly attributable to the strong tax disincentives for giving to private foundations.

VII. MAJOR CONCERN: Tax Disincentives for Gifts to Foundations and the Serious Decline in the Formation of New Foundations

Under existing income tax rules, charitable contributions to private foundations during the lifetime of the donor generally receive significantly less favorable tax treatment in three respects when compared to similar contributions to other charities: first, while a donor can deduct the full value of appreciated property given to a public charity, he or she can deduct only a fraction of that amount if the same property is given to a foundation; second, while deductions for contributions to private foundations are subject to a ceiling of 20 percent of the donor's annual income, substantially higher ceilings apply to gifts to public charities; and third, while contributions to public charities in excess of these annual ceilings may be deducted in future years, this "carryover" does not apply to contributions made to private foundations.

While some of the different treatment of private foundations precedes 1969, it was in that year that these disincentives reached their full height. There is a clear consensus among experienced foundation officials that these discriminatory rules have severely affected the formation of new foundations. The creation of foundations with assets over $1 million dropped sharply after 1969: 759 were started in the 1960's and only 255 in the 1970's. Unfortunately, these figures tell only part of the story. As a percentage of gross national product, contributions to private foundations dropped by 50 percent from 1969 to 1981. In addition, the total assets of private foundations, when adjusted for inflation, fell by 25 percent from 1969 to 1981.*

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* The Foundation Center data cited above provide a far more accurate gauge of the birthrate of significant grantmaking foundations than do IRS figures on the total number of organizations classified as private foundations for tax purposes. As explained in the footnote on page 5 (above), the IRS data include a large, and continually increasing number of organizations which are "burned out" public charities rather than active grantmaking foundations.

It is our firm belief that the tax disincentives are no longer needed to accomplish the objectives for which Congress enacted them. As evidenced by the legislative history, enactment of these restrictions reflected Congressional concern that some foundations were not making reasonable current distributions to operating charities and that high-income donors were realizing a greater "profit," at the Treasury's expense, by donating highly appreciated property than by selling it and paying tax on the capital gain. Congress has directly and effectively addressed both concerns in subsequent legislation, and has thus eliminated entirely the need for the special restrictions on gifts to private foundations.

Congressman Conable, together with Congressmen Shannon, Gephardt, and Frenzel have introduced a bill, H.R. 3043, that would eliminate the discriminatory treatment of lifetime gifts to private foundations. Ten other members of the Ways and Means Committee have already joined as cosponsors. We strongly support this important legislation.

VIII. OTHER IMPEDIMENTS

While removal of the tax disincentives on gifts to private foundations is our most serious concern, there are a number of other issues that we feel your Subcommittee should examine closely. Changes in the law to address these concerns would have two major results: 1) more flexibility in the making of grants, especially to newly formed organizations, and 2) fewer dollars lost to unnecessary administrative or tax penalty costs, and thus more funds available for charitable purposes.

Impediment: 2 Percent Tax on Foundation Investment Income

While every other class of charitable organization is entirely exempt from tax on income from its passive endowment, current law imposes a 2 percent tax on the investment income and realized capital gains of private foundations. In fiscal year 1982 this tax reduced foundation resources by over $93 million dollars, and we fully expect that for 1983 this figure will well exceed $100 million. More significantly, each dollar of tax revenue collected by the government reduces by one dollar the amount which foundations are required by law to distribute annually for charitable purposes. In short, it is not a tax on foundations but a tax on foundation grantees. Designed originally to cover the cost of IRS auditing and supervision of private foundations, it generates today over 14 times the costs involved. By our best estimates, the cost for monitoring the whole field of exempt organizations is approximately $33 million annually, and the cost of supervising private foundations alone is about $6.7 million.

Foundations throughout the country find this tax both unfair and excessive. More reasonable alternatives are clearly available, even if it is accepted that foundations ought to bear the cost of IRS supervision. While we recognize that the current federal deficits make this an inopportune time to raise this issue, we hope that Congress can, before too long, consider removing the only tax on tax-exempt organizations, and thus eliminate the unfortunate result of removing millions of dollars each year that could otherwise be granted to public charities.

Impediment: Divestiture Requirements for Business Holdings Acquired After 1969

The rules against excess business holdings have generated perhaps more controversy in the foundation field than any other part of the 1969 Act, and you will hear a great deal of testimony in the coming days on the issues surrounding these rules. The Council on Foundations has carefully considered these restrictions on business holdings over the years, and has consistently decided against recommending their repeal. Our position on this point remains unchanged. However, we have also consistently felt that one aspect of the rules was unnecessary and counterproductive — namely the short 5-year divestiture requirement for holdings acquired after 1969. A foundation subject to this relatively short deadline is at a substantial disadvantage in negotiating with prospective purchasers who may prolong negotiations in the hope of obtaining a better deal as the deadline pressures increase. An extension of the divestiture period for new holdings to 10 or 15 years would be preferable. As an alternative, we support giving the Secretary of the Treasury authority to grant time extensions where the burden is on the foundation to show that it has exercised good faith efforts to dispose of the holdings in a timely manner.

Impediment: Definition of Family Member

The private foundation rules impose severe restrictions on the relationships which may exist between a foundation and its "disqualified persons," and violations of these restrictions trigger substantial penalty taxes. Under current law, "disqualified persons" with respect to a foundation include substantial contributors to the foundation and all of their lineal descendants, regardless of how many generations separate these descendants form the original contributor, or how distant their relationship may be from the foundation. This rule can impose a costly administrative burden on private foundations, the magnitude of which increases geometrically with each passing generation. To alleviate this problem, we strongly support the provision of H.R. 3043 that would limit the definition of "family member" to children and grandchildren of substantial contributors, and exclude more remote descendants.

Impediment: Reliance on IRS Determinations of Grantees' Tax-Qualified Status

Foundations are required to comply with detailed record-keeping and reporting requirements -- commonly referred to as "exercising expenditure responsibility" -- if they make grants to organizations which are not classified as public charities. The applicable regulations take the position that in important circumstances a foundation contemplating a grant cannot, in determining whether the grantee is a public charity, rely on an official IRS ruling as to the grantee's status. Because of this rule, many foundations feel obliged to devote substantial administrative resources to making their own independent investigations of grantees' sources of financial support. As a practical matter, such investigations almost invariably confirm the grantees' public charity status already recognized by the IRS. Thus, the only effect of the investigation is to consume foundation resources which would otherwise be available to support charitable activities. H.R. 3043 would eliminate this unnecessary administrative cost by permitting foundations, in making grants, to rely on official IRS rulings recognizing the public charity status of potential grantees.

Impediment: Chilling Effect of Expenditure Responsibility Rules

Foundations must comply with detailed record-keeping and reporting requirements with respect to any grant, no matter how small, if that grant is made to an organization which is not a public charity. These "expenditure responsibility" requirements include a pre-grant investigation, a written grant agreement, periodic accountings from the grantee, and the filing of annual reports with the IRS. These requirements are particularly burdensome to small foundations without staff, and even some large foundations may decide to forego small grants to nonpublic charities in order to avoid this drain on their administrative resources. As a result, many small-scale but highly beneficial charitable activities cannot attract foundation support. The chilling effect of the expenditure responsibility rules has made it increasingly difficult for newly emerging, community-based organizations to obtain badly needed seed money grants to get them started. In fact, information gathered by the Council over the years clearly shows that the vast majority of private foundations do not make grants requiring expenditure responsibility. The evidence is also clear that many more foundations would consider such grants absent these requirements. H.R. 3043 would provide strong encouragement for this important aspect of foundation philanthropy by eliminating the expenditure responsibility requirements if the total grants by a private foundation, and all related foundations, to a grantee during a given taxable year do not exceed $15,000.

Impediment: Automatic Imposition of First Level Penalty Taxes

To ensure compliance with the private foundation rules, Congress provided that foundations found in violation would be subject to a multi-level set of penalty taxes. While this sanction mechanism has been quite effective overall, the rules for application of the first level tax have proven to be unnecessarily rigid. Under current law the first level tax is imposed automatically even if the violation is inadvertent and is corrected within the statutory correction period. Because of the complexity of the private foundation rules and the inability of many foundations — particularly smaller foundations — to obtain sophisticated legal counsel, inadvertent violations of these rules do occasionally occur. The result is that foundation dollars that would otherwise be used for grants to charities must be used to pay the penalty tax. To prevent this diminution of foundations' grantmaking capacity, H.R. 3043 would give the Secretary of the Treasury authority to abate first level penalty taxes in cases where he determines that the violation of the private foundation rules was due to a good faith error or omission and was corrected within the statutory period.

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Progress in addressing the impediments we have identified here could result in subtantial improvement in the growth of private foundations and their resources. In addition, more dollars would be available for grantmaking purposes and not diverted to taxes or unnecessary administrative costs.

IX. CONCLUSIONS AND RECOMMENDATIONS

In summary, Mr. Chairman, we submit to you that the diversity of private foundations is one of our most valued attributes. Despite our diversity, we share in common support for significant charitable activities, a cherished tradition of independence, and an exciting potential to provide the venture capital for innovative ideas and changes in today's world and tomorrow's.

Although strictly regulated since 1969, private foundations have come to terms with these comprehensive legal restrictions and are basically supportive of the 1969 Act. However, certain aspects of this legal framework impose unnecessary burdens on foundation philanthropy and should be changed.

H.R. 3043, the Conable-Shannon bill, addresses five of these problems. First, and by far most important, this bill would stimulate increased giving to foundations and the creation of new foundations by eliminating the current tax disincentives for lifetime gifts to private foundations. As explained above, the bill also addresses four more technical defects of current law. We strongly urge the Committee to support this legislation.

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In closing let me say, Mr. Chairman, that the Council welcomes the opportunity your Subcommittee has provided to come before you to tell our story. In the months ahead as you prepare a report and consider legislation, we will be ready to be of service to you in any way we can. Thank you for your attention.

How Many Foundations Are There?

APPENDIX 1

The Foundation Center has identified 22,535 currently active grantmaking foundations in the United States, although the complete Internal Revenue Service files contain records for approximately 5,600 additional foundations which did not award any grants in the year of record or which have not been active during the last five years.

These 22,535 foundations held combined assets of $41.6 billion and awarded grants totaling over $2.8 billion during the 1979-80 fiscal year. The majority of foundation holdings are concentrated in a relatively small number of foundations, with 15 percent of all foundations (3,368) accounting for 92 percent of all assets and 82 percent of the grant dollars awarded. There are only 114 foundations with assets of $50 million or more, yet this small group holds over half of all foundation assets and awards over 37 percent of all foundation grant dollars.

There are significant differences between these few larger foundations and the vast majority of private foundations which hold assets of less than $1 million and award grants under $100,000 annually. Larger foundations are more likely to have paid staff who review and investigate proposals, develop projects, and work with the public. They usually have well-developed statements of program interests, and they make these interests and their application requirements known to the public through annual reports or brochures. Most larger foundations award grants on a national or even an international basis, and their programs may be limited to a specific subject area or cover a wide range of interests. Because of their size and the greater likelihood of paid staff, large foundations are more visible and attract a greater number of funding requests forcing them to be very selective in the grants they award.

Smaller foundations are generally more oriented toward local giving, but within their own community or state, they

1. BREAKDOWN OF FOUNDATIONS BY ASSET CATEGORIES*

Asset Category	No. of Foundations	Assets	Grants
$100 million+	58	$17,042,553,000	$ 815,055,550
$50 million–$99,999,999	56	3,960,848,900	236,379,760
$10 million–$49,999,999	442	9,002,594,300	572,584,130
$5 million–$9,999,999	476	3,331,876,600	278,107,140
$1 million–$4,999,999	2,336	5,129,477,100	441,633,570
$500,000–$999,999	1,823	1,296,116,400	136,714,690
$250,000–$499,999	2,491	879,310,140	110,207,020
$100,000–$249,999	3,774	611,120,000	94,130,408
$50,000–$99,999	2,780	200,655,220	43,997,044
$25,000–$49,999	2,420	88,123,088	37,039,728
$10,000–$24,999	2,321	39,301,232	28,829,850
Under $10,000	3,558	12,100,008	53,127,964
TOTALS	22,535	$41,594,073,879	$2,847,797,509

*Details may not add to totals because of rounding

SOURCE: National Data Book, 6th Edition 1982

2. BREAKDOWN OF FOUNDATIONS BY GRANT CATEGORIES*

Grant Category	No. of Foundations	Grants	Assets
$25 million+	10	$ 460,380,960	$ 8,162,702,800
$10 million–$24,999,999	18	235,403,010	1,450,346,200
$5 million–$9,999,999	46	313,720,930	4,797,723,600
$1 million–$4,999,999	363	717,093,500	9,225,311,200
$500,000–$999,999	424	295,094,140	3,423,317,200
$100,000–$499,999	2,304	496,583,330	6,421,070,300
$50,000–$99,999	1,864	132,093,400	2,263,263,900
$25,000–$49,999	2,582	91,355,064	1,245,777,200
$5,000–$24,999	7,456	91,316,960	1,570,166,300
Under $5,000	7,468	14,744,231	1,032,404,000
TOTALS	22,535	$2,847,797,509	$41,594,073,879

*Details may not add to totals because of rounding

SOURCE: National Data Book, 6th Edition 1982

Trends in Foundation Giving

APPENDIX 2

The Foundation Center first began to record and categorize foundation grants in 1961 and established a computerized grants recording system in 1972. The system is based primarily on voluntary reporting of grants of $5,000 or more awarded by private foundations, although supplemental information is also taken from public records to ensure that the 100 largest foundations are included in the sample.

The sampling base for the 1981 grants analysis included 22,322 grants of $5,000 or more awarded by 369 foundations. These grants amount to over $1.25 billion or 45 percent of annual foundation giving, though the number of foundations covered comprises less than 2 percent of the total number of private grantmaking foundations in the U.S. These statistics, therefore, do not provide a complete picture of the activities of all private foundations, but they do offer a general overview of the grantmaking patterns of the nation's largest foundations.

Table 19 analyzes the distribution of the number and dollar value of grants in seven broad subject areas and 39 subcategories in 1980 and 1981. In looking at the broad categories, grants for welfare or social services comprise the largest percentage of both the number of grants and grant dollars. It appears that this is an area of increasing priority for foundations, while giving for health and education seems to have declined. This trend first became evident in 1980 when reported grants for welfare exceeded those for education for the first time in over five years.

Cultural activities also seems to be an area of growing interest to foundations. There was a 2 percent increase in both the number of grants and the grant dollars allocated to this category in 1981, with noticeable increases in giving to general arts and cultural organizations and to language and literature (including grants for public libraries, reading, creative writing, and foreign language programs, etc.).

In analyzing giving by subcategories, we found that higher education and medical care and treatment receive the largest percentage of both grant dollars and the number of grants, although the percentage of funds allocated to these two areas has declined substantially in the last two years. There has also been a decrease in the percentage of grant dollars allocated for medical research.

An analysis of the types of organizations which received foundation grants reveals that educational institutions received the largest proportion of grant dollars (41 percent) and the number of grants (31.2 percent), with private universities and colleges accounting for over half of this amount. The percentage of grant dollars allocated to these institutions is significantly higher than the percentage of grants, hence the average dollar value of these grants is higher than the grants to other recipient categories.

Direct service agencies, which encompasses social service agencies as well as other organizations providing direct services such as scouting groups, employment services, and recreational agencies, account for 26.8 percent of all grants but only 16.5 percent of the grant dollars reported. The average dollar value of these grants is therefore proportionately lower, as it is with performing arts groups and professional associations.

The Foundation Center also tracks foundation giving in seven types of support categories: capital support (including funds for buildings, purchase of land or equipment, and capital fund drives); continuing support or renewal grants; endowments; fellowships and scholarships; general or operating support (including grants for ongoing programs, services, or staff positions); matching or challenge grants; program development (including special projects, seed money or startup funds, program expansion, and new staff or faculty positions); and research. Table 20 shows the total number and dollar value of grants awarded for these types of support. Some grants fall under more than one category, e.g., "general support" and "continuing support," so the analysis was based on percentages of total grant dollars and number of grants represented in the sample.

Grants for program development or special projects accounted for the largest proportion of both grants and grant dollars, followed by grants for capital support. The

18. TYPES OF ORGANIZATIONS RECEIVING GRANTS

	Total Value of Grants	%¹	No. of Grants	%¹
Educational Institutions	**$14,512,965**	**41.0**	**6981**	**31.2**
Private Universities & Colleges	278,392,767	22.2	3403	15.2
Public Universities & Colleges	88,312,669	7.0	1459	6.5
Graduate Schools	92,033,023	7.3	890	4.0
Junior/Community Colleges	3,405,773	0.3	73	0.3
Schools	52,368,733	4.2	1156	5.2
Direct Service Agencies	**207,672,799**	**16.5**	**5981**	**26.8**
Hospitals & Medical Care Facilities	**114,774,092**	**9.1**	**1489**	**6.7**
Research Institutes	**91,039,640**	**7.2**	**992**	**4.2**
Associations & Professional Societies	**70,088,978**	**5.6**	**1883**	**8.4**
Museums & Historical Societies	**60,706,283**	**4.8**	**904**	**4.0**
Performing Arts Groups	**45,409,155**	**3.6**	**1424**	**6.4**
Government Agencies	**36,850,553**	**2.9**	**518**	**2.3**
Community Funds	**36,140,525**	**2.9**	**608**	**2.7**
Libraries	**33,308,912**	**2.7**	**358**	**1.6**
Churches & Temples	**10,513,774**	**0.8**	**284**	**1.3**

¹Percentages based on total grants reported in this volume, i.e., 22,322 grants with a total value of $1,257,056,099.

[illegible] Foundation Grants Index, 11th Edition, 1982

19. DISTRIBUTION OF GRANTS BY SUBJECT CATEGORIES IN 1980 AND 1981

	Dollar Value of Grants				Number of Grants			
	1980		1981		1980		1981	
	Amount	%	Amount	%	No.	%	No.	%
Cultural Activities								
General	$23,762,428	2.0	$52,323,219	4.2	534	2.5	776	3.5
Art & Architecture	36,277,014	3.0	43,139,967	3.4	498	2.3	554	2.5
History	16,876,510	1.4	12,772,923	1.0	328	1.5	360	1.6
Language & Literature	9,753,803	0.8	20,066,708	1.6	227	1.0	302	1.4
Media & Communications	26,987,020	2.3	20,915,886	1.7	492	2.3	399	1.8
Music	23,439,983	2.0	24,513,970	1.9	610	2.8	799	3.6
Theater & Dance	23,697,126	2.0	18,827,272	1.5	602	2.8	688	3.0
TOTAL CULTURAL ACTIVITIES	160,793,884	13.5	192,559,945	15.3	3,291	15.2	3,878	17.4
Education								
General	18,951,152	1.6	22,764,612	1.8	444	2.0	506	2.3
Adult & Continuing	9,183,695	0.8	9,867,033	0.8	128	0.6	122	0.5
Elementary & Secondary	36,321,496	3.0	46,130,529	3.7	1,053	4.9	997	4.5
Higher (General)	198,304,497	16.7	181,576,053	14.4	2,949	13.7	2,717	12.2
Vocational	3,670,572	0.3	5,513,078	0.4	145	0.7	164	0.7
TOTAL EDUCATION	266,431,412	22.4	265,851,305	21.1	4,719	21.9	4,506	20.2
Health								
General	4,542,588	0.4	15,445,092	1.2	116	0.5	224	1.0
Medical & Health Education	63,758,605	5.4	67,511,593	5.4	553	2.6	587	2.6
Medical Care & Treatment	146,611,811	12.3	118,571,590	9.5	1,593	7.4	1,750	7.8
Medical Research	59,209,996	5.0	53,290,926	4.2	610	2.8	569	2.5
Mental Health	11,246,674	0.9	14,254,591	1.1	357	1.7	446	2.0
Public Health	13,549,063	1.1	13,457,808	1.1	265	1.2	170	0.8
TOTAL HEALTH	298,918,710	25.1	282,531,602	22.5	3,494	16.2	3,746	16.7
Religion								
General			9,330,573	0.8			232	1.0
Religious Education			15,348,099	1.2			172	0.8
TOTAL RELIGION	28,718,935	2.4	24,678,672	2.0	718	3.3	404	1.8
Science								
General			22,689,341	1.8			229	1.0
Life Sciences			31,027,168	2.5			325	1.5
Physical Sciences			17,776,009	1.4			399	1.8
Technology			15,235,026	1.2			315	1.4
TOTAL SCIENCE	75,466,392	6.4	86,727,544	6.9	1,375	6.3	1,268	5.7
Social Science								
General			22,981,978	1.8			316	1.4
Anthropology			944,350	0.1			19	0.1
Economics			12,695,560	1.0			260	1.2
Law & Legal Education			12,343,675	1.0			218	1.0
Political Science			26,465,713	2.1			460	2.1
TOTAL SOCIAL SCIENCE	67,977,493	5.7	75,431,276	6.0	1,182	5.5	1,273	5.8
Welfare								
General	61,309,538	5.1	73,616,556	5.9	2,076	9.7	2,488	11.1
Business & Employment	25,874,641	2.2	37,485,732	3.0	810	3.8	692	3.1
Community Affairs	67,820,185	5.7	80,868,899	6.4	1,507	7.0	1,685	7.5
Consumer Interests			479,061	0.03			22	0.1
Crime & Law Enforcement			10,371,00	0.8			207	0.9
Environment & Conservation	36,616,832	3.0	46,271,003	3.7	587	2.7	589	2.6
Equal Rights & Legal Services	29,303,435	2.5	16,088,325	1.3	584	2.7	361	1.6
Recreation	35,808,927	3.0	38,886,934	3.1	718	3.3	774	3.5
Rural Development	5,459,422	0.5	7,050,882	0.6	84	0.4	89	0.4
Urban Development	30,299,992	2.5	18,157,363	1.4	445	2.0	340	1.5
TOTAL WELFARE	292,222,972	24.5	329,275,755	26.2	6,811	31.6	7,247	32.4
TOTAL GRANTS	$1,190,799,798	100.0	$1,257,056,099	100.0	21,590	100.0	22,322	100.0

dollar value of capital support grants, however, tends to be much higher. Nearly one-fourth of all grants awarded are for the continuing support of organizations which received a similar grant from the same foundation in the preceding year.

In response to requests for more detailed data on foundation giving to special population groups, the Center began tracking grants in 1980 which were designated for the support of ten special population groups. This year the categories were expanded to cover grants designated to-benefit Asian-Americans and men and boys. In 1981, grants designated for these groups accounted for 19.7 percent of all grant dollars reported and 28.1 percent of the number of grants.

Table 21 shows the breakdown of giving to special groups in the 1980 and 1981 grants analyses. Grants for children and youth, not including general support for elementary and secondary education, represent the largest portion of special population grants. There seems to be increased interest in funding projects benefiting women and girls and blacks, both of which received a greater percentage of grants and grant dollars in 1981 than in 1980. The percentage of grants allocated for the aged has remained constant, but the portion of grant dollars allocated to this group has decreased substantially.

20. TYPES OF SUPPORT AWARDED

	Grant Amount	% of all Grant Dollars	Number of Grants	% of all Grants
Capital Support	366.005.714	29.1	4055	18.1
Continuing Support	278.403.296	22.1	5239	23.5
Endowments	60.088.820	4.8	279	1.2
Fellowships & Scholarships	76.840.014	6.1	1209	5.4
Matching or "Challenge" Grants	73,094,291	5.8	636	2.8
Program Development	415.112.018	33.0	6809	30.5
General or Operating Support	148.661.935	11.8	3850	17.3
Research	128.899.585	10.3	1872	8.4

SOURCE: Foundation Grants Index, 11th Edition, 1982.

21. GRANTS AWARDED TO SPECIAL GROUPS

	Dollar Value of Grants				Number of Grants			
	1980		1981		1980		1981	
	Amount	%	Amount	%	No.	%	No.	%
Aged	24,428,374	2.0	18,010,803	1.4	466	2.2	484	2.2
Alcohol/Drug Addicts	4,364,642	0.4	3,159,280	0.3	161	0.7	154	0.7
Children & Youth	86,507,700	7.3	123,552,714	9.8	2677	12.4	3133	14.0
Criminal & Ex-Offenders	7,168,404	0.6	8,435,017	0.7	218	1.0	211	0.9
Handicapped	19,411,746	1.6	22,062,891	1.8	737	3.4	808	3.6
Men & Boys			12,154,657	1.0			257	1.2
Minorities	22,078,451	1.9	23,360,983	1.9	557	2.6	453	2.0
Asian-Americans			1,470,530	0.1			66	0.3
Blacks	22,960,139	1.9	35,696,678	2.8	398	1.8	583	2.6
Hispanics	7,574,670	0.6	10,182,753	0.8	189	0.9	257	1.2
Native Americans	4,842,633	0.4	4,913,173	0.4	109	0.5	123	0.6
Women & Girls	20,533,990	1.7	36,670,100	2.9	634	2.9	966	4.3

APPENDIX 5

The Foundation Center

The Foundation Center is a nonprofit, fact-finding organization with the principal mission of gathering and disseminating information to the public on private foundations and the grants they give. The Center maintains a library network, public education activities, and a publishing program. The Center was established in 1956 at the initiative of private foundation officials who saw a continuing need for public information and orientation about foundations and their grantmaking programs. The list of original sponsors grew from 20 in 1971 to 358 today, representing grantmaking organizations all over the United States.

The Center's library network consists of free reference collections located in public libraries and other community organizations in 130 cities and, in addition to these, four larger libraries operated by the Center itself in Washington, D.C., New York, Cleveland, and San Francisco. There is at least one basic information collection in every state, and sometimes several. At every location, there is a basic shelf of Foundation Center reference books describing every active grantmaking private foundation in the United States, some 22,000 in number. The thousand largest are described in detail (Source Book Profiles), 3,000 others are described in standard Directory entries (Foundation Directory), and there are basic entries for 18,000 mainly small, local foundations (National Data Book).

One hundred three of the public reference points also contain collections of IRS Form 990-PF information returns on private foundations. In most states, the collection is limited to returns for foundations within the state, but some have returns for adjoining states as well. The New York and Washington, D.C. offices contain Form 990-PF returns on film for the entire country, not only for the most recent year, but for earlier years. Through the Center libraries, copies of any of the returns are available to any network library upon request.

The Center purchases from the IRS at a cost of $70,000 several complete national sets of Form 990-PF returns for its own editorial use and for distribution to the free reference collections each year, thus ensuring convenient public examination throughout the country. People who cannot travel to a reference collection may order returns by mail. Key pages from the IRS return of any foundation which does not publish an annual report will be sent at a charge of $2.00 per foundation.

Additional materials available in network collections include directories, grants lists, press clippings, handbooks and other publications and information that give the grantseeker perspective.

APPENDIX 6

Who Uses The Foundation Center Collections?

Who Uses the Returns?

The number of persons using the Foundation Center's materials and services each year numbers several hundred thousand, nearly the entire foundation fundraising community. The number using the IRS Form 990 returns, through direct examination of the returns at Center collections or through the data from the IRS forms which appear in Center publications, is equally large.

The number of visitors to the 134 reference points or to Center-operated libraries reaches about 160,000 per year. In addition, many other libraries purchase the publications and make them available to the public. Upwards of 1,200 libraries in the United States, apart from Center affiliates, hold copies of Center publications. The number of copies of Foundation Center publications published and available for use or sale in 1982-83 comes to about 90,000 copies.

The Foundation Center maintains an active public education program. In 1982, staff members addressed people at 97 national conferences, attended by 5,290 individuals. Staff sent informational materials to 196 additional conferences attended by 22,000 people and conducted 339 orientations and educational seminars lasting from two hours to a full day, and responded to about 30,000 mail or telephone inquiries about private grantmaking. In addition, 1.3 million mailing pieces were distributed in 1982, giving information about the Foundation Center and the availability of its publications. A toll-free 800 number is available for anyone to call the Washington, D.C. office for the locations of the nearest Foundation Center collection or for other information about the Center's programs.

Three of the major publications are also available through personal computer terminals connected by telephone lines to the Lockheed DIALOG system. Anyone using a terminal may access the files from their own office locations. Hundreds of organizations use the service, including Federal agencies such as the Library of Congress.

Chairman RANGEL. Mr. Joseph, what is the purpose of the council?

Mr. JOSEPH. Mr. Chairman, the Council on Foundations was organized in 1949 to promote responsible and effective grant making. We have a membership of almost 1,000. We work with the foundations that are members of the council as well as foundations in the total field of philanthropy to help to promote effective grant making.

I would add, Mr. Chairman, that our concern about the public interest parallels that of this committee as well as the Congress so that since 1969 we have spent a considerable amount of time in encouraging foundations to exercise their public responsibility in public reporting. We have also emphasized the importance of communicating to the multiple publics who have a stake in foundations.

We do a variety of research in areas of concern to the field of philanthropy. We offer professional development workshops and seminars; we seek to encourage creation of additional foundations. These are a few of the things we have done over the last few years.

Chairman RANGEL. And you are satisfied that in view of the Federal budget cutbacks that the foundations, the members of the council, have attempted to fill that gap?

Mr. JOSEPH. Well, Mr. Chairman, that is a very good question, and I shall respond to that in several ways. Those of us who feel the pain of the poor and who feel hurt when people are hungry are always persuaded that people should be doing more.

And I think I share with you a concern that when there are needs to be met, we would like to have every effort exerted to meet those needs. The other point I would make, however, is that the present debate about the social role of government and the focus on foundations as a possible alternative is often ambiguous and very often confusing. The truth of the matter is that foundations do not have the resources to serve as an alternative to government.

But if one looks at what foundations have done during the last few years they have in many ways reassessed their priorities and they have responded in a number of interesting ways to deal with the problems created by the economic recession. But at no time should we think that these resources are sufficient to serve as an alternative to government. And so I have to emphasize that those of us who focus on the potential of the private foundations have a responsibility to also focus on their limitations.

Chairman RANGEL. Do you see any need for voter registration to be restricted to a large, broad geographic area if indeed it is nonpartisan and not alined with specific candidates?

Mr. JOSEPH. Mr. Chairman, the Council on Foundations has not taken a position on this issue. But since I served as a president of a foundation which was one of the earliest supporters of voter registration, I think I can answer that question from my experience as a foundation executive. I happen to believe that encouraging participation in the democratic process, encouraging citizens to participate in policymaking and the selection of their leaders is one of the most noble public purposes that can be served by an institution concerned with the public good. And when I was president of the foundation we made grants for that purpose because we felt it was a very useful and important way of exercising our trust responsibility of the resources we were distributing.

As regards the present law, I was around in 1969 and I remember the debate. I remember the concern, and I remember the compromise that was reached. The compromise of requiring that foundation funding for voter registration be restricted to regional or five States or more evolved from the concern about the possibility of national foundations going in to intervene in local elections. One of the new issues that has come up which some of the foundations have been discussing, is the fact that there are foundations that operate only in a State, or operate only in a local community who would like to be able to encourage increased voter participation in those areas.

And so I think the question then is, given the fact that foundations have been able to support voter registration, whether or not the time hasn't come to see whether or not some sort of formula can be worked out to deal with the problem that Members of Congress were concerned about on the national level, but also to deal with the State and local level.

I happen to think that such a formula could probably be found and worked out.

Chairman RANGEL. So you don't have any problem with the vast majority of the foundations being governed by family members or former family members, or the same people that operate corporate businesses? You don't see that to be any major area that the Federal Government should have concern with?

Mr. JOSEPH. Here again, like the previous question, there are a variety of answers one can give. Private philanthropy and organized philanthropy in this country emanated originally as an act of compassion on the part of individuals who were concerned about social needs of various kind. As this began to be organized and as Government began to provide tax incentives, it was especially appropriate that the Government set regulatory parameters in which these foundations could operate.

I think the 1969 rules with their prohibitions and with their other provisions, have prevented the abuses that might occur. And so I see no problem in the way in which foundations are presently governed and the way in which they presently operate in accordance with the rules of 1969.

Chairman RANGEL. So you don't see any possible conflict between the interests of the foundation as opposed to the interests of the businesses under existing law?

Mr. JOSEPH. I don't see any conflict that would cause legal problems. I might add that the Council on Foundations and I have for some time encouraged foundations to diversify their boards of directors, to diversify their staffs, to consider newly emerging needs and new ways of meeting old needs. I think that is appropriate.

But I don't see any area in which there is need for new law in regards to that concern.

Chairman RANGEL. There is no way that your council can find that we could legislate to reach the objectives which you are encouraging? And that is to have the boards to be more reflective, or to be more representative than those that started the foundation? There is nothing we can do to encourage that?

Mr. **Joseph**. Well, I think that many of the regulations that have already been put in place have served as an impediment. Many lawyers now advise their clients, and many estate planners now advise their clients not to establish foundations because of the large body of regulations, some of which serve as impediments, some of which I have identified in my written testimony.

I would hate to see Congress getting involved in trying to enact legislation and regulatory agencies developing more regulations to serve what we agree is a public good. I think there is a consciousness on the part of foundations that this good ought to be served. And I think there has been progress in that area.

Chairman **Rangel**. Mr. Conable?

Mr. **Conable**. Thank you, Mr. Chairman.

Mr. Joseph, I would like to acknowledge the contribution of the Council on Foundations and thank you for the work that it does annually. I would like also to thank Mr. Troyer, who is with you, for his assistance in preparing the legislation now before the committee relating to impediments.

From your point of view, Mr. Joseph, has the 1969 act tended to make foundations less flexible in the use of their moneys? I recall that your testimony pointed to foundation contributions as more flexible than the uses of public moneys directly. And it has been said by some that the effect of the 1969 act with its punitive provisions was for foundations to pull back into their shells, and to fall back on considerably more conservative types of fund distribution than what some consider to be social experimentation-type grants that preceded the 1969 act.

If flexibility is one of the goals of problem solving out there through the foundation movement, is there too much conservatism on the part of foundations now, in your view and from your perspective, or was it appropriate for us to go back to grants through traditional charities like the eleemosynary institutions, which seemed to be one predictable movement under the 1969 act?

Mr. **Joseph**. Let me first refer to the use of the word "conservative" grantmaking, and then get into the main body of your question. It is true that some foundations make grants which political conservatives would regard as liberal. Other foundations make grants which political liberals would regard as conservative. That is part of the pluralism of the foundation field.

Mr. **Conable**. I am not discussing ideology here, sir. I am talking about the use of traditional charities as outlets because they are safer. I am talking about the safe aspect of foundation grants.

Mr. **Joseph**. One of the problems that occurs when people begin to see foundations as an alternative to government is that foundation philanthropy then begins to go for maintenance grants. The providing for social services for traditional institutions and the maintenance of traditional institutions. So we see foundation philanthropy becoming survival money.

I think you are right in suggesting that in the last few years we have seen a number of foundations bailing out traditional charities and institutions that are very good. But one of the problems that occurs is that $1 spent for this support is no longer available for the sort of creative, innovative kinds of things foundations have often sparked historically.

One of the examples that is often used is to compare foundation philanthropy to the R&D money in a business corporation. When the business corporation begins to devote most of its funds to the operating budget and none to research, it loses its competitive edge. Foundation philanthropy has been sort of the R&D money of American society. If foundations began to devote most of that money to maintenance of traditional charitable good purposes, then the society loses its money for creativity and innovation. So in that sense I share your concern.

Mr. CONABLE. From your perspective that is happening, is it, or has it happened in greater degree since 1969 than before?

Mr. JOSEPH. I would not say the 1969 act has caused it as much as the economic recession and cutback in the Federal budgets has in the last couple of years caused that.

Mr. CONABLE. Thank you.

Chairman RANGEL. I didn't understand that response. Are you saying the cutbacks have caused more to go into research and development?

Mr. JOSEPH. No. I said as a result of the cutback in Federal support for social services and many very good charitable institutions, and traditional organizations, whether university or whatever, foundations have had to go in and help to bail out some of those institutions. And so some of the money that might have been available for innovative purposes, for research, the kind that led to the polio vaccine, for example, will now be used to maintain traditional institutions.

Chairman RANGEL. I see.

Mr. Thomas.

Mr. THOMAS. Thank you, Mr. Chairman.

I want to continue that line of thought, about what people expect out of institutions whether they be governmental or otherwise, when needs are to be met. If government is the institution who met that need, and it no longer supplies the support necessary, they will turn to other institutions. The foundations then have been the recipients of a number of requests for maintaining traditional-type activities, traditional in the sense that since the 1930's they have been performed by government; is that not true?

Mr. JOSEPH. Well, I am not offering a value judgment on what foundations should do. I said at the outset that was part of the pluralism of the field and that should be encouraged. But I have said that as I look at the data of what foundations have been doing, in the last couple years there has been a tendency to bail out some of the institutions that are suffering from Federal cutbacks.

Mr. THOMAS. IRS testimony on page 23 said that our exempt organization master file records indicate an increase of approximately 10,000 private foundations over the last 10 years, from 23,000 at the end of calendar year 1972 to 33,000 at the end of calendar year 1982. They presented a quantitative analysis of foundations.

In your testimony, Mr. Joseph, you indicated in part a qualitative analysis in terms of foundations above a particular dollar size. The million-dollar-plus foundations had declined in number. Could you elaborate a little bit about the qualitative analysis? Is it good that we have large foundations, a large number of foundations with large assets versus small?

I am trying to understand the discrepancy between your position and the IRS. Clearly, they have said there are a number of increases. You have been concerned about the qualitative aspect, the size of the foundations. Can you give me some indication as to the problems that might be caused by a lot of small foundations versus the traditional formative pattern prior to 1969?

Mr. JOSEPH. As I understand your question, there are really two parts, and the one has to do with the general data and the discrepancy between the numbers that I have used and the numbers that the Internal Revenue Service uses. I would simply repeat here that the Internal Revenue Service figures include every organization that has registered as a foundation since they have been keeping records, for one thing.

Second, it includes a number of charities that have been reclassified because they do not meet the public support test. So therefore the figures used by the foundation center are figures which report on the active grant-making foundations which to me is a more realistic universe to discuss, since these others are not doing anything. They exist only on paper.

Mr. THOMAS. The IRS figures are those required to report by law. Your figures are those actively engaged in the business in which foundations are supposed to be engaged?

Mr. JOSEPH. A large number of those the IRS includes in its 33,000 have not reported. They have received an exemption and they exist only on paper. And they still continue to include them.

There are about another 7,000 or 8,000, as I said, who used to be public charities, and IRS has automatically reclassified them as private foundations because they have not met the public support test. The 22,000 all report to the Internal Revenue Service, but they are the remaining number of those who actually make grants and annually file a 990-PF with the Internal Revenue Service.

Mr. THOMAS. Your testimony refers frequently to H.R. 3043 and some of the impediment adjustments contained therein. I am a cosponsor as well of that legislation. And I think it is appropriate. Is there anything else that you think needs to be done beyond 3043, or if 3043 were enacted into law along with the 1969 act, would that be adequate from your perspective, Mr. Joseph?

Mr. JOSEPH. For years the Council on Foundations has been active in trying to identify impediments to foundation philanthropy. Several years ago the council drew up and submitted to the President's Task Force on Private Sector Initiatives a list of impediments. Most of those impediments were included in the report from the Committee on Impediments, which Congressman Conable chaired.

We feel that that legislation which is aimed at removing those impediments reflects as much as we should be requesting of the Congress at this time. I might add that a number of members of the council and other foundations are also strongly concerned about the excise tax. You have heard and seen figures which indicate that the Internal Revenue Service collects about $93 million, and it cost only about $33 million to administer all exempt organizations, and only about $6.7 million to administer foundations.

So I have to say to you that we are concerned about that tax. It is really not a tax; it is not appropriately called an excise tax, but it is called that in the law. We would at some point like to see Congress concern itself with that. But we think, given the present economic climate, that this may not be the time to do it.

Mr. THOMAS. Thank you very much, Mr. Chairman.

[The following was subsequently received:]

COUNCIL ON FOUNDATIONS,
Washington, D.C., July 1, 1983.

Re: Additional written statement.

Mr. JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means, House of Representatives, Longworth House Office Building, Washington, D.C.

DEAR MR. SALMON: Since delivery of my testimony on June 27, 1983, I have been concerned by several comments of Subcommittee members that indicated they might not be completely familiar with the amount of information on foundations now available nationwide. The Foundation Center coordinates a system of public information dissemination that includes four libraries and 130 cooperating collections located in and staffed by host libraries and nonprofit organizations. These cooperating collections contain all of the Center's reference works listed below, recent books and reports on foundations and IRS 990 PF returns for foundations within the state. The national libraries maintain copies of all foundation IRS 990 PF returns and send copies on request. Copies of the Foundation Center publications are also provided by more than 1200 libraries throughout the country. The following directories are available at all Foundation Center locations:

(1) The Foundation Directory which offers descriptions of the nation's 3400 largest foundations (93 percent of all assets). Descriptions include addresses, financial data, trustees, donors, and grant application information.

(2) The National Data Book which lists all 22,500 grantmaking foundations giving addresses, market value of assets, grants paid, gifts received, and fiscal period.

(3) Source Book Profiles which provide for the top 1,000 foundations (80 percent of all assets) a long, in-depth analysis including a full breakdown of each foundation's giving by subject area.

(4) Foundation Grants Index Annual which lists the more than 27,000 grants made to nonprofits and reported to the Center. A bimonthly publication Foundation Grants Index Bimonthly, describes over 2,000 recent grants in each issue.

Libraries and cooperating collections also provide copies of the other Center publications listed in the attached brochures. In addition to these very thorough publications, the Foundation Center and its affiliate libraries provide many more services for grantseekers.

I firmly believe that the records of your hearings on private foundations would be incomplete without a full explanation of the valiant public service performed nationwide by The Foundation Center. Therefore, I respectfully request that the enclosed testimony provided by Mr. Thomas R. Buckman, President of the Center (which he presented to the Commerce, Consumer, and Monetary Affairs Subcommittee on May 11, 1983) be made part of the official record of your hearings as an addition to my written statement.

Your assistance in meeting this request will be greatly appreciated.

Sincerely,

JAMES A. JOSEPH, *President.*

STATEMENT OF THOMAS R. BUCKMAN, PRESIDENT, THE FOUNDATION CENTER

Mr. Chairman, my name is Thomas R. Buckman. I am President of the Foundation Center.

The Foundation Center is a nonprofit, fact-finding organization with the principal mission of gathering and disseminating information to the public on private foundations and the grants they give.

The Center was established in 1956 at the initiative of private foundation officials who saw a continuing need for public information and orientation about foundations and their grantmaking programs.

In the 1970s, a large number of foundations wished to reemphasize their dedication to public knowledge and accountability, and so the list of original sponsors grew from 20 in 1971 to 358 today, representing grantmaking organizations all over the United States.

We carry out our mission through a library network, public education activities, and a publishing program.

The Center's library network consists of free reference collections located in public libraries and other community organizations in 130 cities and, in addition to these, there are four larger libraries operated by the Center itself in Washington, D.C., New York, Cleveland, and San Francisco. There is at least one basic information collection in every state, and sometimes several. At every location, there is a basic shelf of Foundation Center reference books describing every active grantmaking private foundation in the United States, some 22,000 in number. The thousand largest are described in detail, 3,000 others are described in standard Directory entries, and there are basic entries for 18,000 mainly small, local foundations.

One hundred and three of the public reference points also contain collections of IRS information returns on private foundations. In most states, the collection is limited to returns for foundations within the state, but some have returns for adjoining states as well. The New York and Washington, D.C. offices contain returns on film for the entire country, not only for the most recent year but for earlier years. Through the Center libraries, copies of any of the returns are available to any network library upon request.

The Center purchases several complete national sets of returns for its own editorial use and for distribution to the free reference collections each year, thus ensuring convenient public examination throughout the country. Annually, the Center buys filmed returns from IRS costing about $70,000 for this purpose.

The reference collections also include many handbooks, technical assistance guides, and general books from many publishers that are of interest to grantseekers.

Most network cities can be reached in a day's trip from other cities and towns.

We are actively expanding the network and welcome inquiries from those who would like to have a foundation reference collection in their local community.

People who cannot travel to a reference collection may order returns by mail. Key pages from the IRS return of any foundation which does not publish an annual report will be sent at a charge of $2.00 per foundation.

However, the isolated return received in the mail has limited value without the additional materials available in our network collections, such as directories, grants lists, press clippings, handbooks and other information that gives the grantseeker perspective. Visitors to our network collections often learn not only about the funding process but also about other matters relating to the management of their own organizations, and the world of nonprofit human services in general.

WHO USES THE FOUNDATION CENTER COLLECTIONS? WHO USES THE RETURNS?

The number of persons using The Foundation Center's materials and services each year numbers several hundred thousand, which is to say nearly the entire foundation fundraising community. The number using the IRS returns, through direct examination of the returns which we distribute around the country or through the data from the IRS forms which appear in our publications, is equally large.

The number of visitors to our 134 reference points or Center-operated libraries reaches about 160,000 per year. In addition, many other libraries purchase our publications and make them available to the public. Our records show that upwards of 1,200 libraries in the United States, apart from our own affiliates, hold copies of our publications. The number of copies of Foundation Center publications published and available for use or sale in 1982-83 comes to about 90,000 copies.

In 1982, our own library staff members addressed people at 97 national conferences, and these sessions were attended by 5,290 individuals. We sent informational materials to 196 additional conferences attended by 22,000 people. Our staff conducted 339 orientations and educational seminars lasting from two hours to a full day in 1982, and we responded to about 30,000 mail or telephone inquiries about private grantmaking. In addition, we sent out 1.3 million mailing pieces in 1982, giving information about The Foundation Center and the availability of our publications. We maintain a toll-free 800 number which anyone may use to call our Washington, D.C. office for the locations of the nearest Foundation Center collection or for other information about our program.

Three of our major books are also available thorugh personal computer terminals connected by telephone lines to the Lockheed DIALOG system. Anyone using a terminal may access the files from their own office locations. Hundreds of organizations use the service, including Federal agencies such as the Library of Congress.

Although the neophyte fundraiser may never have heard about The Foundation Center at the outset, he or she cannot avoid hearing about the Center after a few days of serious work in foundation fundraising, and can then begin using our resources.

INFORMATION ABOUT FOUNDATIONS—WHERE DO WE GET IT?

The Foundation Center receives a large volume of information used in its publications and public service programs from four sources:

(1) Information sent by foundations and corporations

It comes in a number of forms: annual reports, newsletters, information brochures, application guideline statements, letters informing us of grant awards, and memoranda indicating changes in location, program, or personnel. In addition, many foundations regularly report their grantmaking activities to the Center via a standarized "Grant Reporting Form" which classifies the information for entry in our Grants Index database. Most of this material is later housed in the Foundation Center libraries and make available for use by the public.

(2) Responses to mailings

As a regular part of the publication cycle, The Foundation Center requests information verification or revision by mail, and sometimes by phone: annually from Directory foundations and biennially from foundations listed in Source Book Profiles.

(3) IRS returns filed by foundations

The Internal Revenue Service 990-PF returns filed by private foundations are a third source of information for the Center's publications. Filmed returns are received at the Center's libraries and cooperating collections in monthly installments. The 990s are used by editorial staff for a variety of purposes. Most importantly, they provide information on foundations which do not respond to the Center's annual or biennial mailings.

(4) Media sources

Information in articles on the philanthropic field reported in newspapers, magazines, and journals across the country comes through a clipping service and our own network.

HOW IMPORTANT IS THE 990-PF?

The sources of information on foundations are diverse. The grantseeker should research a funding prospect thoroughly before applying, using all the information available. The 990-PF is a useful starting point for further research. It is essential for identification of foundations which report in no other way. At most, if filled out completely, it may indicate a possible source of funding but cannot be the basis for an applications without the of further gathering information, either from the foundation itself or from other sources.

The Foundation Center gathers much of this additional information for the larger foundations and makes it available to the public.

The grantseeker in the local community in approaching one of the 18,000 very small foundations will go beyond the 990-PF and will use local directories, newspaper reports, conversations with other grantseekers and community leaders. Often local foundations or their local associations will provide information or orientation sessions. It is the mark of the effective grantseeker to gether information like this from a variety of people or records locally. Such information is usually beyond the scope of federal government forms or national directories, however helpful they may be initially.

In summary, the 990-PF can give an important outline of foundation program information and grantmaking, which can be used as a point of departure for futher work by the grantseeker. The completion of the public information sections of the 990-PF would, therefore, be in the public interest.

RECOMMENDATION

My recommendation is that the legislative intent described in the GAO report be clearly reaffirmed; that staff within IRS monitor the provision of this information, and request compliance; and that the Subcommittee recommend modest appropriation of funds to assist IRS in securing this result.

We know from the GAO report that 95 percent or better of the items related to tax administration are obtained by follow-up reminders. Our own experience at The Foundation Center shows that when telephone follow-ups are used to secure information for our Source Book Profiles, which contain lengthy information on the 1,000 largest foundations, we can obtain very complete information in 85 percent of the cases. Therefore, there is no reason to believe that a simple reminder and follow-up procedure could not achieve the result that is needed. The new 990-PF seems to us to be entirely satisfactory in the kinds of questions it asks. It should be made quite clear, however, that no part of the form is optional. The words "Supplemental Information" should be changed to "Required Public Information."

The information sought is not technical in nature but, in most cases, simply descriptive or quantitative. For example, there are many models of adequate grant descriptions in the Center's Foundation Grants Index. As a minimum, each grant should be accompanied by a short descriptive phrase. It would not be difficult for IRS personnel to determine if the filer had complied in answering the grantseeker information questions.

Mr. Chairman, I have attached to this statement several appendices giving further details, and I request that these be included in the record.

Exhibit A—Appendices

CHARTER AND STATEMENT OF POLICY

Charter

The Foundation Center is an educational corporation operating under a Charter issued by the Board of Regents of the University of the State of New York in 1956 and confirmed as an Absolute Charter in 1958:

" . . . The purposes for which such corporation is formed are:

To assemble, catalogue and maintain a library or libraries, open to the public, relating to philanthropy;

To collect, organize and make available to the public (in the corporation's library or libraries and elsewhere) reports and information about foundations organized and operated exclusively for charitable, scientific, literary or educational purposes and which are exempt from income taxation under the laws of the United States:

To promote the development and maintenance of sound standards for reporting by such foundations and to assist them in making such reports available to the public through the use of the corporations's library or libraries and in other ways;

To aid and promote, in any and all lawful ways, the preparation and dissemination of reports to the public by such organizations; and

If and to the extend deemed advisable by its board of trustees, to compile and publish periodically a general directory of foundations and newsletters, reports or other publications concerning them . . . "

In conformity with these purposes, the Center endeavors (1) to be a useful resource for anyone interested in applying to grantmaking foundations for funds; and (2) to compile reliable descriptive data and statistics on the foundation field for the use of foundation trustees and officers, regulatory agencies, and other interested organizations and individuals.

Governance

The Center is an independent, not-of-profit organization governed by its own Board of Trustees.

Incorporators

The original incorporators, serving as the first Board of Trustees, were Julian P. Boyd, Professor of History and editor of The Papers of Thomas Jefferson, Princeton University; John A. Krout, Vice President and Provost of Columbia University; Emory W. Morris, President of W.K. Kellogg Foundation; Vernon Munroe, Jr., partner in the law firm of White and Case; James A. Perkins, Vice President of Carnegie Corporation of New York; Robert L. Sutherland, Director of the Hogg Foundation, the University of Texas, John D. Wilson, Vice President of The Chase Manhattan Bank; John E.F. Wood, partner in the law firm of Dewey, Ballantine, Bushby, Palmer and Wood; and Donald Young, President of Russell Sage Foundation.

Tax status

The Internal Revenue Service determined in 1957 that the Center is exempt from Federal income tax under the provisions of section 501(c)(3) of the Internal Revenue Code and in 1971 that the organization is not a private foundation as defined in section 509(a)(1) of the Code. In 1974, the tax exempt status of the Center was reconfirmed by IRS.

Policies

All information in the Center's files is available equally to those who come in person and to those using fee-based services.

The New York and Washington, D.C. libraries and the field offices operated by the Center, as well as the cooperating collections, are open to the public. Information, including prepared computer searches, is available without charge to library visitors. Qualified staff are on hand to assist.

Users who prefer information service by mail or telephone, special compilations of data by library staff, and custom computer searches by the Center's retrieval specialists may subscribe to the Associates Program for which there is a basic annual fee.

The Associates Program is limited to public and other nonfoundation users. Foundations may request any of these services for their own staff or board use by writing or telephoning the Center. Foundations which contribute substantially to the support of the Center receive these services at no charge, others on a fee basis. A detailed policy statement is available on request.

Computer access to the Center's principal data bases is also available through a national communications network to anyone using remote terminals.

The Center's principal publications are available for sale. Copies of brief information leaflets are distribute in small quantity without charge.

General

The Center takes no position of advocacy. It program of fact finding and dissemination are intended to be as comprehensive as possible. It is committed to full disclosure of information in the public record.

The Center does not direct applicants for funds to particular foundations nor does it arrange introductions to foundation officials or assist persons seeking positions in foundations.

THE FOUNDATION CENTER—HOW TO OBTAIN INFORMATION ABOUT FOUNDATIONS

There are several ways the public can learn about the activities of grantmaking foundations. About 500 foundation publish annual reports and about 50 have their own newsletters. A number of others publish brochures outlining their funding interests. To find out if a foundation publishes such materials you can consult directories such as *The Foundation Directory*, available from The Foundation Center, or you can or write The Foundation Center toll-free (800) 424-9836. Center staff will tell you if materials are available from a particular foundation to the public and provide an address where you can write to obtain copies.

Besides the Foundation Directory, there are many other national and local directories of foundation and corporate grantmakers. Copies of these reference materials are available for free public use at the Foundation Center's national network of grants libraries. The Center is represented in all 50 states by over 90 cooperating collections, as well as its own libraries in New York, Washington, DC, Cleveland, and San Francisco. In addition to funding directories, the libraries have copies of foundation annual reports, newsletters and brochures; foundation files containing news clippings, releases and historical materials; subject indexes to foundation grants; extensive materials on nonprofit management, fund raising, program planning and proposal writing; and information on other sources of funding such as government, corporate, special events, direct mail, etc.

One of the best sources of information about private foundations is the information return they are required to file annually with the Internal Revenue Service. Federal law requires that foundation returns, unlike personal tax returns, be made available to the public by both the IRS and by the foundations themselves. This means that for all foundations, regardless of size, there is a public record available which provides basic facts about their operations and grants. For the more than 19,000 small foundations this is often the only available record of their activities. For the larger foundations it provides data that supplements other available information, generally with more detail about investments and assets than is provided in published sources. Community foundations are not required to file the same IRS forms as private foundations. However, most of the approximately 250 community foundations either publish annual reports or newsletters or in some way make information about their activities well known locally.

WHAT INFORMATION DOES A FOUNDATION IRS RETURN CONTAIN?

There are certain key pieces of information you should alway be able to find on a foundation's return.

(1) Name and address.

(2) Assets at market value, including detailed listings of investments, securities, and other assets.

(3) Gross contributions, gifts or grants of $5,000 or more received by the foundation during the year, including the names of new donors, their address and amount contributed.

(4) Contributions, gifts or grants paid by the foundation. The IRS did not require a foundation to state it purposes on the return until 1981, but for earlier returns you may be able to draw some conclusion based on its list of grants. Most grant lists contain only the amount of the grant and the name of the recipient and do not describe individual grants.

(5) Principal foundation officer and other officers, trustees, directors or foundation managers.

THREE WAYS TO USE FOUNDATION IRS RETURNS

I. Use the services of the Foundation Center

Free public access to foundation IRS returns is available through the Foundation Center, a national nonprofit clearinghouse for information on foundations and grants. The Center's New York and Washington, D.C. libraries have copies of all foundation IRS records. Its offices in San Francisco and Cleveland contain IRS records for foundations in the western and midwestern states respectively. The Center has 90 cooperating collections, including at least one in every state, where copies of IRS returns for foundations in that state are available for review. In many Foundation Center libraries, paper or microfilm copies of pages from foundation returns can be made for a small duplicating fee. Cooperating collections can also order copies of IRS returns for foundation outside their state from The Foundation Center in New York.

Most grantseekers will find a preliminary visits to a Foundation Center library collection the best first step in locating appropriate funding sources. A wide variety of materials is available to help determine which grantmakers might be interested in funding a particular type of program or organization. Examination of a specific foundation's giving record or IRs return is most helpful after it has been determined that the foundation might be interested in the grantseeking organization's area(s) of interest. For the location of the foundation reference collection nearest you, call toll-free (800) 424-9836.

Copies of individual foundation returns can be ordered from The Foundation Center for a small fee. As a special service to grantseekers, foundations have provided funding to assist. The Foundation Center in making copies of foundation IRS returns accessible to the public. The Center will offer copies of key pages from foundation returns for $2 per foundation, a fee below the direct cost of reproduction, as part of a one year experimental program to test public need for this type of service.

Copies will be made of the return of any foundation which does not publish an annual report. If you are not sure if the foundation you are researching publishes an annual report, call The Foundation Center toll-free at (800) 424-9836 and find out. The Foundation Center will supply the address where you may write and request a copy. When available, a published report is generally the best and most complete source of information on a foundation.

For other foundations, submit a letter to The Foundation Center with the names of the foundations for which returns are desired, their city and state location and the date of the return requested (or specify "most recent"). You may order up to six returns in a single request. Orders will be sent within a week. The cost per foundation is $2 and payment must accompany the order. You will receive those pages from the IRS return which contain the following pieces of information: name, address, assets, officers, complete grants list.

II. Contact the foundations

Copies of its 990AR may be inspected in a foundation's office. The IRS requires that foundations make copies of their 990-ARs available in their principal office for public inspection for 180 days after filing. The filing date is four and a half months after the end of the foundation's fiscal year, which is May 15 for the majority of foundations which operate on a calendar year. The foundation must announce in a newspaper of general circulation that the form is available for inspection; generally these may be found in "public notices" sections.

III. Order information through the Internal Revenue Service

Free inspection of any foundation return can be arranged in any of the 19 IRS district offices by writing to the district office and requesting that they obtain copies of specific returns. Generally, they will only have returns for foundations in their district, but others can be ordered. Contact your local IRS office for the address or telephone number of the appropriate district office. It may take four to six seeks for out-of-district returns to arrive, but you will be notified on their arrival and can then inspect or make copies of the returns.

Copies of individual foundation returns can be ordered from IRS for a fee. The cost for ordering copies of returns on apeture cards is $1.00 for the first card and 13¢ for each additional card for each foundation. Aperture cards are tabulator cards on which a small pice of microfilm is mounted. The IRS copies foundation returns on the microfiche, including up to 15 pages per aperture card. The charge for paper copies is $1.00 for the first page of each foundation's return and 10¢ per page thereafter. The paper copy charge is on a per page basis, and therefore substantially more expensive. However, aperture cards are a good alternative only if you have access to a microfilm reader. IRS will send a bill when the order is completed. Allow four to six weeks for fulfillment. Send orders for aperture cards of paper copies of foundation returns to: Mid-Atlantic Service Center, Internal Revenue Service, P.O. Box 245, Bensalem Pennsylvania 19020 Attn: Public Inspection, Drop Point 536.

In ordering IRS returns, include the following information for each foundation requested: full name, city and state location, desired year of return, and, if available, the Employer Identification Number (EIN). This number may be found for all foundations in The Foundation Center's National Data Book and on prior year IRS returns.

Complete sets of foundation returns may be ordered from IRS. State sets are only available on aperture cards, at a fixed price per state. A complete set of all foundations may be ordered for $8,133. Order from the IRS address listed above. Complete sets are available from IRS when annual processing is completed, usually by January for the year prior to that just passed (i.e. 1980 full set available by Jan.-Feb. 1982). Write to the IRS or The Foundation Center for the IRS price list for returns in state sets.

SUMMARY

WHERE YOU CAN GET INFORMATION ON FOUNDATIONS

ORGANIZATION	LOCATIONS	RESOURCES	SERVICES	FEES	FOR MORE INFORMATION
The Foundation Center					
Principal libraries *(Open to the Public)*	New York Washington, D.C.	• IRS returns for all United States foundations (22,535) • Complete set of published foundation annual reports, newsletters • Largest public collections of information on foundations, grants, philanthropy and nonprofit management in U.S.	• Reference librarians available • Free weekly orientation seminars • Copying facilities available • Copies of foundation IRS returns can be ordered by mail	• Library service and orientations free • In-library duplicating service $.25/pg. or microfiche card • IRS returns ordered by mail $2 each	Call toll-free (800) 424-9836 or write The Foundation Center 888 Seventh Avenue New York, New York 10106 for the address and telephone number of the library nearest you
Field Office Libraries *(Open to the Public)*	San Francisco Cleveland	• IRS returns for all foundations in West and Mid-West respectively • Extensive data on funding sources and nonprofit organizations	• Reference librarians available • Free weekly orientation seminars • Copying facilities available	• Library service and orientations free • In-library duplicating service $.25/pg. or microfiche card	
Cooperating Collections *(Open to the Public)*	90 locations throughout the U.S., Mexico, Canada, Puerto Rico, and the Virgin Islands	• IRS returns for all foundations in their state • All Foundation Center publications, plus many additional reference materials for grantseekers	• Reference librarians available • Other sources as locally provided	• Library service free to all visitors	
Offices of Individual Foundations	Throughout the U.S.	• Approximately 600 will send copies of published annual reports upon request • Upon request, all 22,535 foundations will make copies of their IRS return available in their offices			• The Foundation Center will provide addresses for foundations issuing annual reports • The Foundation Center National Data Book lists addresses of all 22,535 foundations
Internal Revenue Service					
19 District Offices	Throughout the U.S.	• Copies of IRS returns for foundations in their district available for inspection • Returns for foundations outside the district can be obtained by the office upon request	• Copying facilities generally available	• No fee for inspection of IRS returns • Nominal charge for copying returns	Write Mid-Atlantic Service Center Internal Revenue Service P.O. Box 245 Bensalem, PA 19020 Attn: Public Inspection Drop Point 536
Mid-Atlantic Service Center	Bensalem, PA	• All IRS returns on file	• Copies of individual foundation returns can be ordered by mail • Full sets of foundation returns may be ordered by state or nationally	• Individual returns copied — $1 first page $.10 per each additional page • Write IRS or Foundation Center for fee schedule for state sets	

PUBLICATIONS OF THE FOUNDATION CENTER
The Basic Books of Philanthropy

Ⓕ

DESCRIPTIONS AND ORDER FORM

Source Book Profiles

This quarterly information service provides 3-6 page analyses of the 1,000 largest foundations. *Profiles* contains the most current, comprehensive foundation descriptions with breakdowns by subject area of giving, type of grant support awarded, and type of recipient organizations.

$200 1983 annual subscription — 500 Profiles cumulated in quarterly volumes

________copies

$200 complete set of 500 Profiles issued in 1982.

________copies

The Foundation Directory, Ed. 8

For over 20 years, this has been the authoritative guide to foundations and their grantmaking interests. All foundations with assets of $1 million or more or grants exceeding $100,000 are described — these 3,363 grantmakers represent about 90% of all foundation dollars.

$45 / 672 pages / Sept 1981

________copies

The Foundation Directory Supplement

This new service provides updates between biennial editions of *The Foundation Directory*. 1,752 Directory entries have been completely revised — changes in personnel, addresses, telephone numbers, application deadlines and procedures and funding priorities are noted and new fiscal data is included (primarily 1981).

$20 / 391 pages / Dec 1982

________copies

National Data Book, 7th Ed.

This is the only directory published which includes all 22,000 active U.S. foundations. The brief profiles make this the ideal source for beginning your research on small, local foundations.

$45 / 2 volumes / Jan 1983

________copies

Corporate Foundation Profiles

Detailed analyses of 221 company-sponsored foundations are provided, plus brief profiles of an additional 381 corporate foundations. This is a truly comprehensive guide to the largest corporate foundations and their giving programs and priorities.

$50 / 540 pages / 1981 rev. ed.

________copies

Foundation Grants to Individuals, 3rd Ed.

This is the only directory devoted entirely to foundation grant programs for individual applicants. Over 950 foundations awarding more than $36 million annually to individuals are described.

$15 / 236 pages / 1982

________copies

Foundation Grants Index Annual, 12 ~~11~~th Ed.

This is the best source of current information about foundation giving interests because it describes their actual
27,000 grants. Over ~~22~~,000 grants awarded by ~~399~~ major foundations 450
1.5 and valued at ~~$1.29~~ billion are included and fully indexed by subject areas, recipients, key words, and geographic focus.

Foundation Grants Index Bimonthly

This new service reports on more than 2,000 recent grants in each bimonthly issue. Special features include details on foundation and corporate annual reports, program brochures, and newsletters; full bibliographic information on current literature in philanthropy; updates on new foundations and reports on foundation changes; plus special reports and grants analyses.

$20 annual subscription / Bimonthly beginning with Jan/Feb 1983 issue

________copies

COMSEARCH: BROAD TOPICS

Recent foundation grants are indexed and analyzed in 11 broad subject areas. Each **BROAD COMSEARCH** includes all grants reported to The Foundation Center in that category in 1980-81 — plus

- an index of foundations with addresses and notes about specific limitations in their giving.
- a key word index for that field.
- an index of all recipient organizations listed.

$28 each / 1982

1. GRANTS FOR ARTS & CULTURAL PROGRAMS – Lists approximately 3,000 grants awarded for arts and cultural programs, including art education, performing and visual arts programs, film and video projects, theater and drama, dance, music, historic preservation, humanities and classical studies.

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2. GRANTS FOR BUSINESS & EMPLOYMENT – About 1,000 grants to support research and education in all areas of business and employment, including career development, vocational training, job placement programs, business law and business development.

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3. GRANTS FOR CHILDREN & YOUTH – Over 3,000 grants supporting services and activities for infants, children and youths to age 18, as well as research and advocacy programs related to the health and welfare of youth.

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4. GRANTS FOR HIGHER EDUCATION – About 6,000 grants to public and private universities and colleges, junior and community colleges, graduate schools, associations and other support groups concerned with higher education.

________copies

5. GRANTS FOR HOSPITALS & MEDICAL CARE PROGRAMS – Over 2,000 grants to a wide variety of medical care facilities including drug and alcohol abuse treatment centers, hospices, nursing homes, health associations, and community health centers.

________copies

6. GRANTS FOR MUSEUMS – About 900 grants awarded to museums, archives, arboretums, zoos, planetariums, botanical gardens, historical societies, art galleries and

[illegible]

PUBLICATIONS OF THE FOUNDATION CENTER

The Basic Books of Philanthropy.

COMSEARCH: BROAD TOPICS – (Continued)

7. GRANTS FOR SCIENCE PROGRAMS – About 1,400 grants for programs in the natural and physical sciences, computer and agricultural technology, and the life sciences.

________copies

8. GRANTS FOR SOCIAL SCIENCE PROGRAMS – About 2,000 grants for research, education, and other programs in the areas of sociology, anthropology, economics, law, political science, business education, psychology, and behavioral science.

________copies

9. GRANTS FOR WOMEN & GIRLS – Over 950 grants for activities benefiting women and girls, including educational programs, legal advococy, health services, vocational training and employment, social services, and research.

________copies

10. GRANTS FOR INTERNATIONAL AND FOREIGN PROGRAMS – Over 1,000 grants for programs undertaken by institutions and organizations in foreign countries and to U.S. organizations for international activities.

________copies

11. GRANTS FOR MINORITIES – Over 1,400 grants for services and activities benefiting minority groups, as well as research and advocacy programs related to minorities.

________copies

Foundation Fundamentals

A detailed guide to funding research which includes illustrations, examples, worksheets, and checklists to help nonprofits develop effective fundraising strategies.

$6.50 / 148 pages / 1981 rev. ed.

________copies

New Information Technologies for the Nonprofit Sector

This conference report provides 8 case studies which explore the practical details as well as the larger issues involved in designing and utilizing new systems and technology.

$4.95 / 42 pages / 1982

________copies

To order the above publications, please complete both sides of the order blank and send to:

The Foundation Center
888 Seventh Avenue
New York, New York 10106

For additional information or to place credit card orders, call toll free (800) 424-9836.

TOTALS: Number of items ordered __________ $__________

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ATTENTION: ____________________
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ADDRESS: ____________________

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The Foundation Center

The Foundation Center has a nationwide network of reference collections for free public use which fall within four basic categories. The reference libraries operated by the Center offer the widest variety of user services and the most comprehensive collections of foundation materials, including all Center publications; books, services and periodicals on philanthropy; and foundation annual reports, newsletters and press clippings. The New York and Washington, D.C. libraries contain the IRS returns for all currently active private foundations in the U.S. The Cleveland and San Francisco field offices contain IRS records for those foundations in the midwestern and western states, respectively.

Cooperating collections contain IRS records for those foundations within their own state, and a complete collection of Foundation Center publications. Local affiliate collections (★) provide a core collection of Center publications for free public use.

Some reference collections (•) are operated by foundations or area associations of foundations. They are often able to offer special materials or provide extra services, such as seminars or orientations for users, because of their close relationship to the local philanthropic community. All other collections are operated by cooperating libraries or other nonprofit agencies. Many are located within public institutions and all are open to the public during a regular schedule of hours.

Please telephone individual libraries for more information about their holdings or hours. To check on new locations call toll-free 800-424-9836 for current information.

Where to Go for Information on Foundation Funding

Reference Collections Operated by The Foundation Center

The Foundation Center
888 Seventh Avenue
New York, New York
10106
212-975-1120

The Foundation Center
1001 Connecticut Avenue,
NW
Washington, D.C. 20036
202-331-1400

The Foundation Center
Kent H. Smith Library
739 National City Bank
Bldg.
629 Euclid
Cleveland, Ohio 44114
216-861-1933

The Foundation Center
312 Sutter Street
San Francisco, Calif. 94108
415-397-0902

Cooperating Collections

ALABAMA

Birmingham Public Library
2020 Park Place
Birmingham 35203
205-254-2541

Auburn University at
Montgomery Library
Montgomery 36193
205-279-9110

ALASKA

University of Alaska,
Anchorage Library
3211 Providence Drive
Anchorage 99504
907-263-1848

ARIZONA

Phoenix Public Library
Social Sciences Subject
Department
12 East McDowell Road
Phoenix 85004
602-262-4782

Tucson Public Library
Main Library
200 South Sixth Avenue
Tucson 85701
602-791-4393

ARKANSAS

Westark Community
College Library
Grand Avenue at Waldron
Rd.
Fort Smith 72913
501-785-4241

Little Rock Public Library
Reference Department
700 Louisiana Street
Little Rock 72201
501-374-7546

CALIFORNIA

• California Community
Foundation
Funding Information Center
1151 West Sixth Street
Los Angeles 90017
213-413-4719

★ Riverside Public Library
3581 7th Street
Riverside 92501
714-787-7201

★ California State Library
Reference Services, Rm. 309
914 Capitol Mall
Sacramento 95814
916-322-0369

San Diego Public Library
820 E Street
San Diego 92101
714-236-5816

Foundation Center
San Francisco Field Office
see address above

Santa Barbara Public Library
Reference Section
40 East Anapamu
P.O. Box 1019
Santa Barbara 93102
805-962-7653

★ Central Sierra Arts Council
19411 Village Drive
Sonora 95370
209-532-2787

★ North Coast Opportunities,
Inc.
101 West Church Street
Ukiah 95482
707-462-1954

COLORADO

Denver Public Library
Sociology Division
1357 Broadway
Denver 80203
303-571-2190

CONNECTICUT

Hartford Public Library
Reference Department
500 Main Street
Hartford 06103
203-525-9121

★ D.A.T.A.
81 Saltonstall Avenue
New Haven 06513
203-776-0797

DELAWARE

Hugh Morris Library
University of Delaware
Newark 19711
302-738-2965

FLORIDA

Jacksonville Public Library
Business, Science, and
Industry Department
122 North Ocean Street
Jacksonville 32202
904-633-3926

Miami—Dade Public Library
Florida Collection
One Biscayne Boulevard
Miami 33132
305-579-5001

★ Leon County Public Library
Community Funding Resources Center
1940 North Monroe Street
Tallahassee 32303
904-487-2665

★ Orlando Public Library
10 North Rosalind
Orlando 32801
305-425-4694

GEORGIA

Atlanta Public Library
1 Margaret Mitchell Square at Forsyth and Carnegie Way
Atlanta 30303
404-688-4636

HAWAII

Thomas Hale Hamilton Library
General Reference
University of Hawaii
2550 The Mall
Honolulu 96822
808-948-7214

•★ Community Resource Center
The Hawaiian Foundation
Financial Plaza of the Pacific
111 South King Street
Honolulu 96813
808-525-8548

IDAHO

Caldwell Public Library
1010 Dearborn Street
Caldwell 83605
208-459-3242

ILLINOIS

• Donors Forum of Chicago
208 South LaSalle Street
Chicago 60604
312-726-4882

Sangamon State University Library
Shepherd Road
Springfield 62708
217-786-6633

INDIANA

★ Indiana University Northwest Library
3400 Broadway
Gary 46408
219-980-6580

Indianapolis—Marion County Public Library
40 East St. Clair Street
Indianapolis 46204
317-269-1733

IOWA

Public Library of Des Moines
100 Locust Street
Des Moines 50308
515-283-4259

KANSAS

Topeka Public Library
Adult Services Department
1515 West Tenth Street
Topeka 66604
913-233-2040

★ Wichita Public Library
223 South Main
Wichita 67202
316-262-0611

KENTUCKY

•★ Louisville Community Foundation
623 West Main Street
Louisville 40202
502-585-4649

Louisville Free Public Library
Fourth and York Streets
Louisville 40203
502-584-4154

LOUISIANA

East Baton Rouge Parish Library
Centroplex Library
120 St. Louis Street
Baton Rouge 70802
504-389-4960

New Orleans Public Library
Business and Science Division
219 Loyola Avenue
New Orleans 70140
504-524-7382 ext. 33

MAINE

University of Southern Maine
Center for Research and Advanced Study
246 Deering Avenue
Portland 04102
207-780-4411

MARYLAND

Enoch Pratt Free Library
Social Science and History Department
400 Cathedral Street
Baltimore 21201
301-396-5320

MASSACHUSETTS

• Associated Grantmakers of Massachusetts
294 Washington Street
Suite 501
Boston 02108
617-426-2608

Boston Public Library
Copley Square
Boston 02117
617-536-5400

★ Walpole Public Library
Walcott Avenue at Union Street
East Walpole 02032
617-668-0232

★ Western Massachusetts Funding Resource Center
Campaign for Human Development
Chancery Annex, 73 Chestnut Street
Springfield 01103
413-732-3175

★ Grants Resource Center
Worcester Public Library
Salem Square
Worcester 01608
617-799-1655

MICHIGAN

Alpena County Library
211 North First Avenue
Alpena 49707
517-356-6188

Henry Ford Centennial Library
16301 Michigan Avenue
Dearborn 48126
313-943-2337

Purdy Library
Wayne State University
Detroit 48202
313-577-4040

Michigan State University Libraries
Reference Library
East Lansing 48824
517-353-8816

★ Farmington Community Library
32737 West 12 Mile Road
Farmington Hills 48018
313-553-0300

University of Michigan—Flint Library
Reference Department
Flint 48503
313-762-3408

Grand Rapids Public Library
Sociology and Education Dept.
Library Plaza
Grand Rapids 49502
616-456-4411

Michigan Technological University Library
Highway U.S. 41
Houghton 49931
906-487-2507

MINNESOTA

Minneapolis Public Library
Sociology Department
300 Nicollet Mall
Minneapolis 55401
612-372-6555

★ Saint Paul Public Library
90 West Fourth Street
Saint Paul 55102
612-292-6311

MISSISSIPPI

Jackson Metropolitan Library
301 North State Street
Jackson 39201
601-944-1120

MISSOURI

• Clearinghouse for Mid-continent Foundations
Univ. of Missouri, Kansas City
Law School, Suite 1-300
52nd Street and Oak
Kansas City 64110
816-276-1176

Kansas City Public Library
311 East 12th Street
Kansas City 64106
816-221-2685

• Metropolitan Association for Philanthropy, Inc.
5600 Oakland, G-324
St. Louis 63110
314-647-2290

Springfield—Greene County Library
397 East Central Street
Springfield 65801
417-866-4636

MONTANA

Eastern Montana College Library
Reference Department
Billings 59101
406-657-2262

★ Montana State Library
Reference Department
930 East Lyndale Avenue
Helena 59601
406-449-3004

NEBRASKA

W. Dale Clark Library
Social Sciences Department
215 South 15th Street
Omaha 68102
402-444-4822

NEVADA

Clark County Library
1401 East Flamingo Road
Las Vegas 89109
702-733-7810

Washoe County Library
301 South Center Street
Reno 89505
702-785-4190

NEW HAMPSHIRE

• The New Hampshire Charitable Fund
One South Street
P.O. Box 1335
Concord 03301
603-225-6641

★ Littleton Public Library
109 Main Street
Littleton 03561
603-444-5741

NEW JERSEY

★ The Support Center
744 Broad Street, Suite 1106
Newark 07102
201-643-5774

New Jersey State Library
Governmental Reference
185 West State Street
P.O. Box 1898
Trenton 08625
609-292-6220

NEW MEXICO

New Mexico State Library
325 Don Gaspar Street
Santa Fe 87503
505-827-2033

NEW YORK

New York State Library
Cultural Education Center
Humanities Section
Empire State Plaza
Albany 12230
518-474-7645

Buffalo and Erie County
Public Library
Lafayette Square
Buffalo 14203
716-856-7525

Levittown Public Library
Reference Department
One Bluegrass Lane
Levittown 11756
516-731-5728

Plattsburgh Public Library
Reference Department
15 Oak Street
Plattsburgh 12901
518-563-0921

Rochester Public Library
Business and Social
Sciences Division
115 South Avenue
Rochester 14604
716-428-7328

Onondaga County Public
Library
335 Montgomery Street
Syracuse 13202
315-473-4491

NORTH CAROLINA

North Carolina State Library
109 East Jones Street
Raleigh 27611
919-733-3270

• The Winston-Salem
Foundation
229 First Union National
Bank Building
Winston-Salem 27101
919-725-2382

NORTH DAKOTA

★ Western Dakota Grants
Resource Center
Bismarck Junior College
Library
Bismarck 58501
701-224-5450

The Library
North Dakota State
University
Fargo 58105
701-237-8876

OHIO

Public Library of Cincinnati
and Hamilton County
Education Department
800 Vine Street
Cincinnati 45202
513-369-6940

Foundation Center
Cleveland Field Office
see address above

★ Ohio Dept. of Economic
and Community
Development
Office of Grants Assistance
30 E. Broad Street, 24th
floor
Columbus 43215
614-466-2480

Toledo—Lucas County
Public Library
Social Science Department
325 Michigan Street
Toledo 43624
419-255-7055 ext. 211

OKLAHOMA

Oklahoma City University
Library
NW 23rd at North
Blackwelder
Oklahoma City 73106
405-521-5072

Tulsa City—County Library
System
400 Civic Center
Tulsa 74103
918-592-7944

OREGON

Library Association of
Portland
Education and Documents
Rm.
801 S.W. Tenth Avenue
Portland 97205
503-223-7201

PENNSYLVANIA

★ Northampton County Area
Community College
Learning Resources Center
3835 Green Pond Road
Bethlehem 18017
215-861-5358

★ Erie County Public Library
3 South Perry Square
Erie 16501
814-452-2333

The Free Library of
Philadelphia
Logan Square
Philadelphia 19103
215-686-5423

Hillman Library
University of Pittsburgh
Pittsburgh 15260
412-624-4528

RHODE ISLAND

Providence Public Library
Reference Department
150 Empire Street
Providence 02903
401-521-7722

SOUTH CAROLINA

★ Charleston County Public
Library
404 King Street
Charleston 29401
803-723-1645

South Carolina State Library
Reader Services Department
1500 Senate Street
Columbia 29211
803-758-3181

SOUTH DAKOTA

South Dakota State Library
State Library Building
322 South Fort Street
Pierre 57501
605-773-3131

TENNESSEE

Knoxville—Knox County
Public Library
500 West Church Avenue
Knoxville 37902
615-523-0781

Memphis Public Library
1850 Peabody Avenue
Memphis 38104
901-528-2957

TEXAS

• The Hogg Foundation for
Mental Health
The University of Texas
Austin 78712
512-471-5041

Corpus Christi State
University Library
6300 Ocean Drive
Corpus Christi 78412
512-991-6810

Dallas Public Library
Grants Information Service
1515 Young Street
Dallas 75201
214-749-4100

• El Paso Community
Foundation
El Paso National Bank
Building
Suite 1616
El Paso 79901
915-533-4020

★ Funding Information Center
Texas Christian University
Library
Ft. Worth 76129
817-921-7000 ext. 6130

Houston Public Library
Bibliographic & Information
Center
500 McKinney Avenue
Houston 77002
713-224-5441 ext. 265.

Funding Information Library
1120 Milam Building
115 E. Travis Street
San Antonio 78205
512-227-4333

UTAH

Salt Lake City Public Library
Information and Adult
Services
209 East Fifth South
Salt Lake City 84111
801-363-5733

VERMONT

State of Vermont Department of Libraries
Reference Services Unit
111 State Street
Montpelier 05602
802-828-3261

VIRGINIA

Grants Resources Library
Ninth Floor
Hampton City Hall
Hampton 23669
804-727-6496

Richmond Public Library
Business, Science, &
Technology Department
101 East Franklin Street
Richmond 23219
804-780-8223

WASHINGTON

Seattle Public Library
1000 Fourth Avenue
Seattle 98104
206-625-4881

Spokane Public Library
Funding Information Center
West 906 Main Avenue
Spokane 99201
509-838-3361

WEST VIRGINIA

Kanawha County Public
Library
123 Capitol Street
Charleston 25301
304-343-4646

WISCONSIN

Marquette University
Memorial Library
1415 West Wisconsin
Avenue
Milwaukee 53233
414-224-1515

WYOMING

Laramie County Community
College Library
1400 East College Drive
Cheyenne 82001
307-634-5853

CANADA

• Canadian Centre for
Philanthropy
185 Bay Street, Suite 504
Toronto, Ontario M56 1K6
416-364-4875

MEXICO

Biblioteca Benjamin
Franklin
Londres 16
Mexico City 6, D.F.
525-591-0244

PUERTO RICO

Universidad del Sagrado
Corazon
M.M.T. Guevarra Library
Correo Calle Loiza
Santurce 00914
809-728-1515 ext. 343

VIRGIN ISLANDS

College of the Virgin Islands
Library
Saint Thomas
U.S. Virgin Islands 00801
809-774-1252

Does Your Community Have A Funding Information Center?
If Not, Look Into The Foundation Center's Affiliates Program

What Does a Funding Information Center Do?

Affiliates are nonprofit agencies or libraries that provide fundraising information or other funding-related technical assistance in their communities. Affiliates agree to provide free public access to a basic collection of Foundation Center publications during a regular schedule of hours, offering free funding research guidance to all visitors. Many also provide a variety of special services for local nonprofit organizations using staff or volunteers to prepare special materials, organize workshops, or conduct library orientations.

The affiliates program began in 1981 to continue the expansion of The Foundation Center's funding information network of 90 funding information collections. Since its inception, 30 organizations have been designated Foundation Center affiliates. Affiliate collections have been established in a wide variety of host organizations, including public and university libraries, technical assistance agencies, and community foundations. The Center maintains strong ties with its affiliates through regular news bulletins, the provision of supporting materials, the sponsorship of regional meetings, and by referring the many nonprofits that call or write to The Foundation Center to the affiliate nearest them.

How to Become a Foundation Center Affiliate Collection

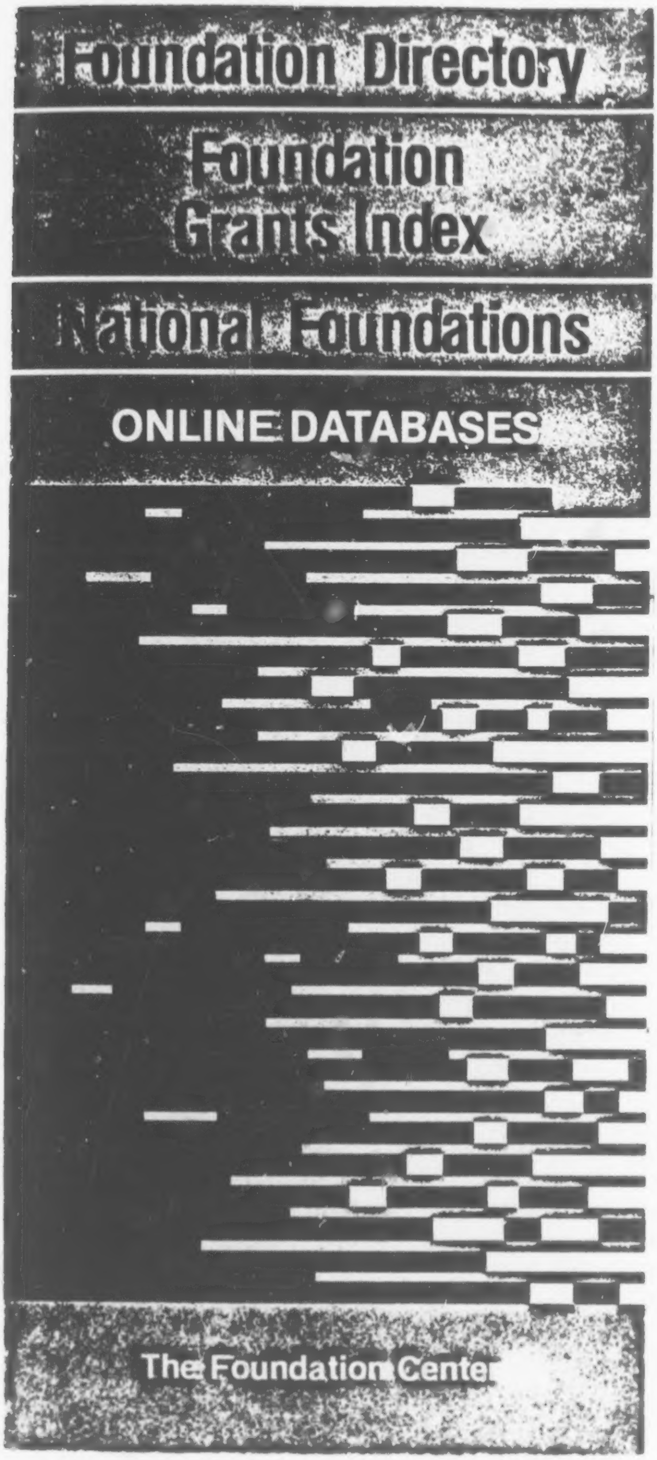
The Foundation Center welcomes inquiries from agencies interested in providing this type of public information service in their community. If you are interested in establishing a funding information library for the use of nonprofit agencies in your community or in learning more about the program, we would like to hear from you.

The first step is for the director of your organization to write to Jane Malik, Network Coordinator, explaining how the responsibilities of network participation would be met and requesting an application form. Upon submission of the completed application form and the requested supporting documents, the Center will contact you to review the details of the relationship. After your agency is designated an affiliate, you will then be entitled to purchase a core collection of Foundation Center materials at a special 20% discount rate (annual cost of $262). Center staff will be happy to assist in identifying supplementary titles for funding information libraries and can arrange for the purchase and monthly shipment from the Internal Revenue Service of private foundation returns on microfilm. A core collection consists of current editions of the following publications:

The Foundation Directory
Foundation Grants Index
Source Book Profiles
National Data Book
Foundation Fundamentals

For more information and an application form, please write to: Jane C. Malik, The Foundation Center, 888 Seventh Avenue, New York, NY 10106 or call collect at 212-975-1120.

12/82



Foundation Directory

Foundation Grants Index

National Foundations

ONLINE DATABASES

The Foundation Center

If you are a grantseeker or researcher, and you have questions like these:

Which New York foundations support urban projects? Who are their officers and trustees?

What are the program interests of the ten largest corporate foundations? Which ones publish annual reports?

Foundation Directory (DIALOG File 26)

Description: Covers over 3,300 U.S. independent, corporate, and community foundations with assets over $1 million, or annual grants totaling $100,000 or more

Features:
- Full foundation addresses and names of officers and trustees
- Descriptions of broad giving interests
- Complete fiscal information
- Application information for grantseekers
- Semiannual updates

Which foundations have given grants in excess of $100,000 in the past two years for continuing education for women?

Which foundations would be likely to fund a cancer research project at a California hospital?

Foundation Grants Index (DIALOG File 27)

Description: Includes more than 140,000 actual grant descriptions for grants of $5,000 or more reported by approximately 500 foundations from 1973 to the present

Features:
- Retrospective data on giving patterns
- Comprehensive subject access to grant-funded projects
- Names and locations of recipient organizations, plus amount and purpose of grants
- Bimonthly updates

Which are the ten largest foundations in Philadelphia by annual grants amount?

What are the names and addresses of smaller foundations in the 441 zip code area?

National Foundations (DIALOG File 78)

Description: Covers all 22,500 active U.S. foundations reporting to the Internal Revenue Service

Features:
- Access to smaller foundations not included in Foundation Directory Database
- Mailing addresses and principal officers
- Brief fiscal information: annual assets, grants, gifts received
- Annual updates

you need
The Foundation Center
databases ONLINE!

1/5/1
ID No. 001807 EI No. 136170340
Booth Ferris Foundation
30 Broad Street, New York, NY 10004 (212) 269-3850

Trusts established in 1957 and 1958 in New York; merged in 1964

Donor(s): Chancie Ferris Booth, Willis H. Booth.

Purpose and Activities: Broad purposes; grants primarily for higher education, including theological education; also urban programs, social agencies and cultural activities in New York City. No grants to individuals, for research, or for community chests; no grants outside the United States; no loans. Report issued annually

Financial Data (yr. ending 12/31/81):

Assets: $60,328,173 AM Expenditures: $5,438,166

Grants Amount: $4,721,750 No. of Grants: 68 High: $ 280,000 Low: $5,000

Trustees: Robert J. Murtagh/ Morgan Guaranty Trust Company of New York//

WRITE: Robert J. Murtagh, Trustee

APPLICATION INFORMATION: Initial approach by telephone, letter, or full proposal in 1 copy; board meets bimonthly

FOUNDATION DIRECTORY DATABASE

1/5/3
2340485
Mott (Charles Stewart) Foundation, MI

$196,200 to Smith College, Ada Comstock Scholars Program, Northampton, MA. For fourth-year support for project, operated as an adjunct to Ada Comstock Scholars Program, that enables mothers on welfare to complete work for bachelor's degree. 3/3/82

PROFILE: Private university or private college.

POPULATION GROUP: Women or girls

TYPE OF SUPPORT: Continuing support; Program development

REFERENCE: Jill Conway, Pres.

SOURCE: 4/15/82 FF, D

FIELD OF ACTIVITY: Higher education

KEY WORDS: Women, college scholarships/ scholarships (college) women/Welfare, women

FOUNDATION GRANTS INDEX DATABASE

2/5/1
ID No. 006622 EI No. 236234669
PEW MEMORIAL TRUST
229 S 18TH ST, PHILADELPHIA, PA 19103
GLENMEDE TRUST CO., TTEE
Profile: TRUST, FOUNDATION

Financial Data (yr. ending 12/80): Assets at Market Value: $1,077, 735,781 Assets at Book Value: $297,170,966

Liabilities: $0 Contributions Received: $0 Expenditures: $48,561,587 Grants Awarded: $45,478,267 Undistributed Income: $49,778,818 Officers' Compensation: $1,671,913

NATIONAL FOUNDATIONS DATABASE

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- ☐ DIALOG Information Services
- ☐ Foundation Center publications and services
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Mail to

The Foundation Center
888 Seventh Avenue
New York, NY 10106

Or call

(800) 424-9836
(212) 975-1120 (in New York City)
(202) 331-1400 (in Washington, D.C.)

FOUNDATION AND GRANTS INFORMATION ONLINE

As the only nonprofit organization whose sole purpose is to provide information on philanthropic activity, The Foundation Center offers three important databases online — FOUNDATION DIRECTORY, FOUNDATION GRANTS INDEX, and NATIONAL FOUNDATIONS. The databases correspond in form and content to the printed volumes: *The Foundation Directory, The Foundation Grants Index*, and the *National Data Book*. Online retrieval provides vital information on funding sources, philanthropic giving patterns, grant application guidelines, and the financial status of foundations to:

Nonprofit organizations seeking funds
Grantmaking institutions
Corporate contributors
Researchers
Journalists
Legislators

The Center's up-to-date and authoritative data is available online through DIALOG Information Services.

Further information on DIALOG searching, including full documentation of all three Foundation Center databases, can be obtained by writing or calling:

DIALOG Information Services, Inc.
Marketing Dept.
3460 Hillview Avenue
Palo Alto, CA 94304

(800) 227-1927
(except CA)

(800) 982-5838
(in California)

Other Foundation Center Services

Information Programs

The Foundation Center operates an extensive public service and education program through its four libraries and its national network of more than 130 free reference collections of grants information.

Associates Program

The Associates Program provides customized services to grantseekers for an annual fee. This program offers Associates toll-free telephone reference, library research services, and fee-based custom searches of the Center's three databases.

Searches for Grantmakers

The Center will perform customized computer searches for foundations and corporate grantmakers on a fee basis. Statistical analyses and special formats are available to grantmakers through this service.

Publications

The reference books published by The Foundation Center are the primary working tools for grantseekers, grantmakers, and researchers. The three database-produced volumes — *The Foundation Directory, Foundation Grants Index* and *National Data Book* — also offer the online searcher a guide to the form, content, and indexing of the corresponding databases. *COMSEARCH Printouts* are copies of computer searches of the Foundation Grants Index Database in more than 80 subject categories.

For more information on Foundation Center publications and services, return the attached form.

Chairman Rangel. Mr. Joseph, I want to thank you not only for your testimony today but for the good work that is being done by the council, and for the help that you have been giving to the subcommittee to try to get through this. I hope that if your schedule permits that you might be able to stay with us a little longer, and if necessary, respond to the next panel which may have different views about foundations.

Mr. Joseph. I will be pleased to do that, Mr. Chairman. I will also be pleased to come back at any other time you feel would be effective or helpful.

Chairman Rangel. Thank you very much, Mr. Joseph.

[The following was subsequently received:]

COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, D.C. July 15, 1983.

Mr. JAMES JOSEPH
President and Chief Executive Officer, Council on Foundations Washington, D.C.

DEAR MR. JOSPEH: Thank you for your participation in the Oversight Subcommittee's recent hearings concerning private foundations. In order to complete our hearing record, your response to the following questions would be appreciated:

(1) What are the Council's membership fees? What other fees are charged for any service or information material that the Council provides to members and non-members?

(2) During the hearing, witnesses commented that the rules regarding lobbying by public charities were so unclear that foundations are reluctant to make grants to any Section 501(c)(3) organization engaged in lobbying activities. Is this a technical problem with the statute or one of perception? Do you have many suggestions for clarification?

(3) Several witnesses suggested that a valuable use for a portion of the 2 percent excise tax would be to provide a Federal directory or national clearinghouse of information on foundations. Please comment.

(4) During your testimony, you referred to a Council study of minority composition of trustees and boards. Please submit a copy of this study for inclusion in the record.

(5) Aren't the reasons affecting the formation of new foundations considerably more complex than simply the more restrictive charitable contribution limits of the tax law? Don't economic conditions, as well as the reduction in the estate tax, figure importantly in this phenomenon?

(6) The Califorina Attorney General's statement presented recommendations for improvements in the Federal tax law relating to private foundations. Specifically suggested were the following: (a) changes in the self-dealing rules to impose guidelines or limitations on fees and administrative expenses paid to disqualified persons, possibly a percentage of annual income or qualifying distributions; (b) application of more stringent payout rules to, and limitations on administrative expenses of, conduit foundations; (c) requiring the diversification of foundation investments; (d) assessment of penalty taxes against foundation managers rather than the foundation itself; (e) imposing a continuing duty on foundation managers to use their best efforts to divest any excess business holdings at the best available price and to report on their efforts annually. Would you please comment on each of these questions.

I would appreciate your response by Friday, August 5, 1983. If you have any questions, please contact Bill Kirk, Staff Director, or Rusty Gurtiz, Assistant Counsel, of the Subcommittee staff at 225-5522.

Thank you for your assistance.

Sincerely yours,

CHARLES B. RANGEL, *Chairman.*

COUNCIL ON FOUNDATIONS,
Washington, D.C., August 5, 1983.

Hon. CHARLES B. RANGEL,
Chairman, Subcommittee on Oversight, Committee on Ways and Means, Longworth House Office Building, Washington, D.C.

DEAR CHARLIE: I am writing in response to your letter to me of July 15, 1983, in which you presented six different questions for me to answer. As always, the Council is pleased to be of assistance.

Question 1. What are the Council's membership fees? What other fees are charged for any service or informational material that the Council provides to members and non-members?

The cost of membership in the Council varies from a minimum of $100 to a maximum of $20,000 annually depending on the size of the organization. The size is sometimes based on assets and sometimes on grants paid (see attached copies of our application/renewal forms). While the bulk of our information and materials are provided at no cost, for some publications and some training workshops we charge a fee or registration to meet expenses. There is also a registration fee at our annual conference.

Question 2. During the hearing, witnesses commented that the rules regarding lobbying by public charities were so unclear that foundations are reluctant to make grants to any Section 501(c)(3) organization engaged in lobbying activities. Is this a technical problem with the statute or one of perception? Do you have any suggestions for clarification?

With the enactment of the Tax Reform Act of 1976, we believe that Congress clearly spelled out the circumstances under which public charities may lobby. However, since the Tax Reform Act of 1969 clearly said that private foundations may not lobby, the question becomes: "May a private foundation legally make a general support grant to a public charity that is involved in legislative lobbying, particularly a charity that has 'elected' to use the special rules governing legislative activities enacted in 1976?" Six years ago, the Council was able to obtain a private letter ruling on this point for one of its members (McIntosh). This ruling approved such a grant so long as there was no "agreement, oral or written" which directed that the grant funds be used for lobbying purposes. In short, the grant could not be "earmarked". The problem, of course, is that private letter rulings are technically applicable only to the taxpayer involved. Despite our urging, IRS has not converted this letter ruling into a generally applicable revenue ruling.

The Subcommittee could perform a great service in helping to clarify this area by including report language similar to the IRS letter ruling, and urging the Service to publish a revenue ruling to the same effect.

Question 3. Several witnesses suggested that a valuable use for a portion of the 2 percent excise tax would be to provide a Federal directory or national clearinghouse of information on foundations. Please comment.

If the Subcommittee feels that there is "extra" revenue available from the 2 percent excise tax, it is the Council's strong opinion that those funds should be made available to the foundations for payment to grantees. Moreover, we feel that the Foundation Center is doing an extremely thorough job providing not one but several private foundation directories of excellent quality in its cooperating libraries in every state. In addition, the newly formed National Center for Charitable Statistics is providing admirable leadership in new research about the private sector. What is truly needed are new approaches to data collection and analysis on the part of the Internal Revenue Service as mentioned in my letter to you of July 19, 1983.

Question 4. During your testimony, you referred to a Council study of minority composition of trustees and boards. Please submit a copy of this study for inclusion in the record.

The study referred to is a part of our 1982 Compensation and Benefits report which we submitted to staff earlier. An additional copy is enclosed.

Question 5. Aren't the reasons affecting the formation of new foundations considerably more complex than simply the more restrictive charitable contribution limits of the tax law? Don't economic conditions, as well as the reduction in the estate tax, figure importantly in this phenomenon?

No, we feel strongly the correlation is straightforward and direct. A recent canvassing of lawyers for the American Bar Association indicates the primary reason for not forming private foundations is the charitable contributions limitation. This finding confirms our own experience and input from professionals in the philanthropic field who advise donors about future courses of action. The reduction in the estate tax was not enacted until 1981, with a slow phase-in period not beginning until 1982. Therefore, this new law has had no effect on the dramatic 60 percent drop in the formation of "Directory size" grantmaking foundations since the Tax Reform Act of 1969. While there is no question that economic conditions always affect charitable giving generally, there is no indication that economic conditions have had any effect on the birthrate issue. During the 1970's there were fluctuations both up and down in economic conditions. Such changes have not caused the problem and will not cure it.

Question 6. The California Attorney General's statement presented recommendations for improvements in the Federal tax law relating to private foundations. Specifically suggested were the following: (a) changes in the self-dealing rules to impose guidelines or limitations on fees and administrative expenses paid to disqualified persons, possibly a percentage of annual income or qualifying distributions; (b) application of more stringent payout rules to, and limitations on administrative expenses of, conduit foundations; (c) requiring the diversification of foundation investments; (d) assessment of penalty taxes against foundation managers rather than the foundation itself; (e) imposing a continuing duty on foundation managers to use their best efforts to divest any excess business holdings at the best available price and to report on their efforts annually.

Let me respond to each of these issues separately:

(a) Cap of fees.—The Council does not believe that additions to the rules on self-dealing are necessary to prevent abuse. The regulations clearly spell out time-honored standards of "reasonable and necessary" expenses that cannot be "excessive". These standards are used frequently throughout the Internal Revenue Code and have proved satisfactory for 70 years. Any instances of particular concern in California should be carefully audited by IRS as soon as possible.

(b) Conduit foundations.—If additional limitations on administrative fees or more stringent payout rules are to be considered for conduit foundations, the Council would urge great caution in how such foundations are defined. Presently, almost all company foundations would be considered conduit, as would many family foundations where family members use the foundation vehicle as a means of coordinating their individual annual contributions. Tougher payout rules on these foundations would have little effect since most have very high payouts anyway—often exceeding 100 percent. However, new limitations on administrative costs could cause unwarranted hardships. Since these conduit foundations are required to pay out the funds received within 2½ months of the year of receipt, slightly higher administrative costs than the norm might be justified. However, in cases like Keck in California where you have one foundation simply turning over all its income to another foundation where grants are then made, the circumstances are much different. The Council is concerned about unnecessary delays in reaching charity and by the potential for duplicative administrative costs. We would be responsive to possible legislative remedies to prevent these activities.

(c) Diversification.—Since the vast majority of private foundation portfolios are already diversified, the Council is not anxious to see more limitations on the management of foundations introduced without a clear showing of need. The "chilling effect" on the formation of new foundations created by the 1969 Act does not need new additions without a clearly demonstrated need. We also wonder what kind of standards, or rules, you could legislate in this area without falling into the type of difficult complexity now encountered under the excess business holding rules.

(d) Taxes on managers, not foundations.—In its wisdom, we believe Congress carved out a very careful balance between wanting to hold private foundation managers accountable personally for their actions and not discouraging good persons from being willing to serve on boards. How one devises such penalties is a delicate challenge, and we would not want to disturb what is now in place. However, we are in agreement with the California Attorney General to some extent. We would greatly favor a procedure to abate first-level penalty taxes as spelled out in H.R. 3043.

(e) Continuing duty to divest.—In principle, we do not disagree with requiring such a duty, but we do feel such a duty would be difficult to define and enforce. More specifically, we would prefer to see this duty applied as suggested in H.R. 2032, which provides the Treasury Secretary with authority to grant time extensions for diverstiture only if the foundation can demonstrate that it has "in good faith taken reasonable steps to dispose of the excess business holdings."

Thank you for the opportunity to comment on these issues. We are very pleased with the speed and efficiency with which you are moving things along with your Subcommittee, and we stand ready to assist in any way that we can.

Sincerely yours,

JAMES A. JOSEPH, *President.*

Chairman RANGEL. The next panel is the Independent Sector, Brian O'Connell, president; National Committee for Responsive Philanthropy, Robert Bothwell, executive director; and Waldemar A. Nielsen of New York, a consultant and author of the book "The Big Foundations."

STATEMENT OF BRIAN O'CONNELL, PRESIDENT, INDEPENDENT SECTOR

Mr. O'CONNELL. Thank you, Mr. Chairman.

Chairman RANGEL. Mr. O'Connell, and panel, the subcommittee has your full statement and you may proceed. As I indicated earlier, we are going to try to operate under the 5-minute rule. Without objection, all your statements will appear in the record.

Mr. O'CONNELL. Thank you, Mr. Chairman. I am Brian O'Connell, president of Independent Sector, which is a unique organization that Mr. Conable helped to put together out of his lasting concern for this whole sector. We are a curious organization of foundations, corporations, and voluntary groups, and within the voluntary side of it include groups that are profamily planning and those that are antifamily planning, those that are profree trade and anti. It truly represents the full spectrum of voluntary institutions.

Previously I served as executive director of the Coalition of National Voluntary Organizations and was for 12 years executive director of the National Mental Health Association. From all these vantage points, I have had full opportunity to learn about the work of foundations and their place in our society.

A summary of my view of foundations in the American society is as follows:

First, I believe passionately that pluralism and citizen participation are among the greatest strengths of America. I also believe as you do, Mr. Conable, that to have such diversity we have to have organizations that are in fact independent. It follows in my mind that to have true independence you have to have the potential of multiple sources of funds. That leads me to realize that there are only three sources of such funds: foundations, corporations, and individuals. That leads me to believe that if we are to have that kind of pluralism, that kind of vibrant independent voluntary sector, we have to do everything humanly possible to encourage those three sources of contributed funds, including foundations.

In my mind the protection for the public and protection for donees is best achieved by the requirement for regular and full disclosure of the makeup, finance and activities of all such organizations, including foundations. I personally believe that overwhelmingly, foundations in this country do serve the public interest.

It is important that the term and concept of pluralism not be lost in generalization. Let me be specific. One doesn't have to go back over the 300 years of our history to find examples of the importance of independent and often unpredictable citizen action. I prefer to reflect on the last 15 years when this kind of pluralism has given rise to a staggering array of causes, rights of women, conservation and preservation, education on our free enterprise system, learning disabilities, refugees, Hispanic culture and rights, the aged, mental health, native Americans, the dying, experimental theater, international understanding, population control, neighborhood empowerment, and on and on. All of these great efforts have depended in some part on foundation support to achieve their high levels of influence.

I also find it helpful in talking to others, and perhaps even to this sophisticated committee, to remind people, when we think of foundations our first reaction might be to think about Ford, Rockefeller, and Mellon. But overwhelmingly the foundations of our country are oriented to their local communities. You have just had a discussion of whether there are 22,000 or 28,000 or 33,000. Whether it is the higher or lower figure, almost all function only or primarily at the local or regional level. If you look at the foundation directory, which only includes the largest of these, those with assets of a $1 million, even there one is hard-pressed to find familiar names among those 10 percent of foundations. You find names like the Eloise and Richard Webber Foundation of Detroit, or the Bing Fund of Southern California; Fannie E. Ripple Foundation in Northern New Jersey; Max and Anna Levinson Foundation of Philadelphia; John Ben Snow Foundation of Up-State New York; the Riggs Benevolent Fund in Little Rock; the Phil Hardin Foundation in Mississippi.

The median foundation grant is under $5,000 and there are a quarter of a million gifts each year, mostly to local museums, hospitals, day-care centers, historical societies, job training programs, clinics, nonprofit theaters, minority causes and the other institutions that are a vibrant part of every community.

Because foundations are so diverse and dispersed it is hard, if not absolutely impossible, to try to get a handle on them. Whenever we do try we tend to want to over generalize and often begin to limit the freedom that is the secret of their contribution to our society. Some are interested in art but maybe only African art; some are interested in the aged, but only Jews or Lutherans; some are interested in hospitals, but only in Portland. They are not responsible for the general welfare no matter how much we may want them to be if our particular cause seems neglected. But that independence and diversity are a very real part of the value of the foundation movement.

In our desire to achieve appropriate accountability of these far-flung and sometimes far-out organizations, I would hope we would be meticulously careful not to stifle the very freedom that represents their special strength and role. Who can predict where the next important ideas or financial support will come from? If governmental direction becomes too controlling, we will achieve the ultimate contradiction of cherishing America's heritage of pluralism and creativity while removing the independence on which those qualities depend.

Our protection both as donees and as the public should be represented by requirements of full disclosure, no self-dealing and the minimum 5-percent payout.

I very much hope that the principal focus of this committee will be to encourage greater development rather than greater control of independent organizations including foundations. There are some risks and some groups will behave dreadfully, but to apply too much direction for independent organizations is to take the far greater risk of limiting their ability to be different and to see things differently.

Though Independent Sector has not yet taken an official position on H.R. 3043, our very large and diverse Government relations committee has studied it and unanimously recommends its passage. They believe it would be an important step in the direction of expanding the grantmaking capacity of foundations.

In conclusion, I have probably had as much opportunity as anyone to observe the foundation world and to be frustrated by its diversity and some of its limitations. Through it all, I am extremely positive about the role that foundations play in contributing to our appropriate and indeed necessary diversity and pluralism. As long as such institutions are willing to disclose fully their makeup, finances and activities, I encourage the maximum possible expansion of their numbers, grantmaking size and independence.

Thank you.

[The prepared statement follows:]

STATEMENT OF BRIAN O'CONNELL, PRESIDENT, INDEPENDENT SECTOR

My name is Brian O'Connell, president of Independent Sector, a membership organization of 500 national voluntary organizations, foundations and corporations which have banded together to strengthen our national traditions of giving, volunteering and not-for-profit initiative.

Our Voting Members are organizations with national interests and impact in philanthropy, voluntary action and other activities related to the independent pursuit of the educational, scientific, health, welfare, cultural and religious life of the nation. The range of members includes National Council of Churches, United Negro College Fund, American Association of Museums, Boys' Clubs of America, American Enterprise Institute, Brookings Institution, Catholic Charities, Audubon Society, Goodwill Industries, American Association of Retired Persons, Opera America, National Urban League, Council for the Advancement and Support of Education, American Association of University Women, YM & YWCA's, B'nai B'rith, Native American Rights Fund, American Cancer Society, U.S. Committee for UNICEF, Organization of Chinese Americans, National Puerto Rican Coalition and 480 other equally diverse organizations. The common denominator among this vast mix is their shared determination that the voluntary and philanthropic impulses shall remain a vibrant part of America.

I served previously as Executive Director of the Coalition of National Voluntary Organizations and was for twelve years Executive Director of the National Mental Health Association. From all these vantage points, I've had full opportunity to learn about the work of foundations and their place in our society.

A summary of my view of foundations in the American society is as follows:

(1) I believe that pluralism and citizen participation are among the greatest strengths of America. They spawn the organizations that give the country and its people options and alternatives and vehicles for service, experimentation, creativity, criticism and reform.

(2) In order to have such pluralism and diversity, voluntary organizations must have every opportunity to be independent.

(3) Independence requires multiple sources of potential funding.

(4) There are only four sources of independent funding—(a) individuals, (b) corporations, (c) earned income, such as tuition or ticket sales, and (d) foundations.

(5) If in fact we are to have vibrant independent organizations, we have to encourage maximum development of all four sources of funds including foundations.

(6) Encouragement of pluralism, diversity and maximum citizen participation require the greatest freedom of action for both donee and donor organizations.

(7) Protection from abuse of that independence is best achieved by a requirement of regular and full disclosure of the makeup, finances and activities of all such organizations.

(8) Overwhelmingly almost all foundations are serving the public good.

It's important that the term and concept of pluralism not be lost in generalization. Let me be specific. One doesn't have to go back over the 300 years of our history to find examples of the importance of independent and often unpredictable citizen action. Just in the past 15 years, citizen service and influence have had profound impact on a staggering array of public issues: the rights of women, conservation and preservation, education on our free enterprise system, learning disabilities, refugees, Hispanic culture and rights, the aged, mental health, native Americans, the dying, experimental theatre, international understanding, population control, neighborhood empowerment, and on and on.

All of these great efforts have depended on foundation support to achieve their high levels of influence.

It's important, too, to understand that most of the foundations that contribute to these important changes and to the maintenance of excellence in many established institutions are local operations. The Internal Revenue Service says that there are 28,000 foundations. Of these, the Foundation Center reports that fewer than 10 percent or only 2,600 are private foundations with assets of about one million dollars and/or which provide annual giving of about $100,000. Even among the 2,600, the overwhelming majority function only or primarily at their community level. They are an important part of the fabric of their communities and regions. When one thinks of foundations, names like Ford and Rockefeller come to mind but a glance through the Foundation Directory makes clear that even among the only 10 percent listed, most foundations would be known only to their local communities. For example, the Walter and Elise Haas Fund of San Francisco; Esther A. and Joseph Klingenstein Fund of New York; David and Lucile Packard Foundation of Palo Alto; Eloise and Richard Webber Foundation in Detroit; Bing Fund of Southern California; Fannie E. Ripple Foundation in Northern New Jersey; Max and Anna Levinson Foundation of Philadelphia; John Ben Snow Foundation of Up-State New York; the Riggs Benevolent Fund in Little Rock; The Phil Hardin Foundation in Mississippi.

The median foundation grant is under $5,000 and there are at least a half-million gifts each year, mostly to local museums, hospitals, day care centers, historical societies, job training programs, clinics, nonprofit theatres, minority causes and the other institutions that are a vibrant part of every community.

Because foundations are so diverse and dispersed it is hard to get a handle on the whole field. Sometimes it's maddening to find foundations that have an interest in a project I think deserves funding and at some point every grant seeker feels that foundations in general don't view the grantee's area of interest with sufficient priority. Some are interested in art and maybe only African art; some are interested in the aged, but only Jews or Lutherans; some are interested in hospitals, but only in Portland. They are not responsible for the general welfare of all people and they are as independent and disparate as the sector as a whole. But that independence and diversity are a very real part of the value of the foundation movement.

In our desire to achieve appropriate accountability of these far flung and sometimes far out organizations, we have to be meticulously careful not to stifle the very freedom that represents their special strength and role. Who can predict where the next important ideas will come from? If governmental direction becomes too controlling, we will achieve the ultimate contradiction of cherishing America's heritage of pluralism and creativity while removing the independence on which those qualities depend.

Our protection both as donees and as the public should be represented by requirements of full disclosure, no self-dealing and the minimum 5 percent payout.

I hope that the principal focus of this Committee will be to encourage greater development rather than greater control of independent organizations including foundations. There are some risks and some groups will behave dreadfully, but to apply too much direction for independent organizations is to take the far greater risk of limiting their ability to be different and to see things differently.

Though Independent Sector has not yet taken an official position on H.R. 3043, our very large and diverse Government Relations Committee has studied it and unanimously recommends its passage. It would be an important step in the direction of expanding the grant making capacity of foundations.

In conclusion, I've probably had as much opportunity as anyone to observe the foundation world and to be frustrated by its diversity and some of its limitations. Through it all, I am extremely positive about the role that foundations play in contributing to our appropriate and indeed necessary diversity and pluralism. As long as such institutions are willing to disclose fully their makeup, finances and activities, I encourage the maximum possible expansion of their numbers, grantmaking size and independence.

Mr. CONABLE. Mr. Bothwell.

STATEMENT OF ROBERT O. BOTHWELL, EXECUTIVE DIRECTOR, NATIONAL COMMITTEE FOR RESPONSIVE PHILANTHROPY

Mr. BOTHWELL. Yes, sir. Thank you.

I am Robert Bothwell, executive director of the National Committee for Responsive Philanthropy.

The committee is concerned about the very low level of private philanthropic funding for newer and smaller organizations, especially those that are questioning inequities in our society. We are also very concerned about accountability of private philanthropy to the public.

I hope, Mr. Chairman, that you allow me to insert my complete remarks into the record so I may summarize here.

Mr. CONABLE. Without objection, all your statements will be included.

Mr. BOTHWELL. Thank you.

We believe foundations are unique institutions in our society. We believe in them and we believe Congress should continue their existence. There are two major reasons for our feelings.

First, they add immeasurably to our pluralism. The 22,000 grantmaking foundations increase substantially the number of different decisionmakers deciding who gets private support. As we well know, private support is increasingly important in these years as government funding decreases. Without foundations nonprofit groups which are not yet ready to seek funds from the general public would be limited in their search for private funds to United Way and major corporations.

Second, foundations are also important because of their independence; they are not dependent on pleasing the voting public nor on making a short-term profit. This independence gives foundations great potential to look hard at the inequities in our society and to help correct them. It gives them great potential to target their funds on groups whose activities are maintaining the vitality and flexibility of our nation and its institutions, helping them to adapt to changing times.

Many foundations indeed have realized that potential. But many more have not. Most have been content with supporting the same well-established, noninnovative, noncontroversial activities year after year, heeding not the development of major citizen movements expressing new aspirations

This fact, which we think is a very important fact to understand about foundations, will surprise many people. Foundations have an image, one that is fostered by the rhetoric from new right organizations, of being active crusaders for social change. While some foundations have made extremely valuable contibutions to social justice, unfortunately, most have not. We urge the subcommittee to read carefully the extensive review of national and local studies of foundation giving patterns contained in our full testimony which vividly illustrates this proposition.

Why have many foundations not realized their potential? Why have so many been removed from so much of what has been happening in this country during the past 20 years? One major reason has to do with who makes the decision about who benefits. Unfortunately, most of these people come from a very narrow segment of our population. A survey recently done by the Council on Foundations concluded that: "Foundations are still directed predominantly by white males nearing the end of their careers."

But the problem is not simply who sits on foundation boards. The problem is also one of attitudes of foundation trustees and the actions they take. Citing another report for the Council on Foundations by John Nason, most foundations "continue to think of the foundation as the donors or as 'ours' and resent suggestions for greater accountability, greater accessibility, greater diversity of viewpoint on the board."

Most founations indeed lack open contact with the public and with grant-seekers. Only around 500 of the 22,000 foundations voluntarily publish and disseminate annual reports about their activities.

In our NCRP national study in 1980 of 208 of the largest foundations, we found that 30 percent refused to provide any information to the public, and of the remaining 70 percent which do, only 59 percent of their annual reports provide minimally acceptable information. Also, currently only a handful of foundations conduct open public meetings at least once a year.

What I have just related tells us clearly how reluctant many foundations are to be open and generally communicative with the public and grant-seekers. Yet without openness and free-flowing information exchange, not even to mention expansive personal interaction between foundations and grant-seekers, how are charities and other nonprofits unknown to foundation trustees and staff to have a serious chance of being considered for support?

The foregoing also speaks clearly about most foundations' limited sense of public accountability. The GAO report on foundations' compliance with Federal reporting requirements, which you will hear of tomorrow, adds tremendously to our knowledge, for it tells us that most foundations fail to provide all the key information that the public and grant-seekers need.

So what should be done? The annual tax return that foundations file with the IRS, the 990–PF, which is what the GAO studied, is an absolutely critical source of information on foundations. In fact, it is the only source of public information on 21,500 of the 22,000 grant-making foundations. The very good work of the foundation center in providing information about foundations depends on this 990.

The legions of nonprofit groups which do not have personal connections with foundation trustees or staff depend on 990 information for their clues to foundation funding.

We have included in our complete testimony four recommendations to improve the usefulness of the 990 and its availability. We hope the subcommittee will seriously consider these.

As a fifth recommendation to expand foundations' contact with the public we recommend that Congress require all larger foundations to hold annual public meetings of their trustees.

There are other factors that contribute to the reluctance of foundations to support many newer, smaller, sometimes controversial organizations. You, yourself, Mr. Conable, have recognized at least one of these: The "expenditure responsibility" requirement which prohibits grants to organizations that do not have public charity status unless some rigorous rules are followed.

As you said, "this administrative burden discourages foundations from making many small but worthwhile grants." We would add that the expenditure responsibility requirements have a substantial chilling effect on foundations' willingness to be venturesome by funding small grassroots organizations. Therefore, we recommend that Congress revise the current law so that foundations do not need to report grants under $5,000 to organizations not recognized as public charities.

While we are often critical of foundations, as we have indicated, we also strongly support their existence. We are thus concerned about reports about the birthrate of foundations and that it may be declining. It has been suggested by some people that the birthrate of new foundations has declined because donors do not have as much tax incentive to give to private foundations as to public charities and because of the whole set of regulations imposed on private foundations by the Tax Reform Act of 1969, such as the requirement that foundations dispose of excess business holdings. However, to paraphrase W. C. Fields, we think reports of the death of foundations may be greatly exaggerated.

Before Congress makes changes in critical regulations from 1969, we urge very careful analysis of available statistics on foundation birthrates. Our full testimony is a good place to start. If, however, Congress eventually decides that foundations should receive more of the tax benefits received by public charities, then we strongly urge that any increase in tax incentives for gifts to private foundations be accompanied by substantially increased public accountability requirements.

After all, increases in tax incentives mean fewer dollars for the public treasury through income, or estate taxes. The trade-off is clear. Our recommendations for these requirements are listed in our complete testimony.

In summary, we believe in foundations and in the important pluralistic, independent, sources of funding. They are for nonprofit activities of all types.

But we do believe changes are needed. Our recommendations are designed to improve foundations' responsiveness to newer organizations and newly perceived needs, especially by expanding and ultimately improving contact between foundations, most of which are very isolated, and the public, particularly grant-seekers. Grant-seekers who do not have personal contacts in the foundation world, and these are the majority, need congressional help to expand their possibilities for the contact which has always been so essential in obtaining foundation funds.

The general public has a right to expect more in public accountability from tax exempt institutions controlling $50 billion in assets.

Thank you, sir.

Chairman **Rangel**. Thank you, Mr. Bothwell.

[The prepared statement follows:]

STATEMENT OF ROBERT O. BOTHWELL, EXECUTIVE DIRECTOR OF THE NATIONAL COMMITTEE FOR RESPONSIVE PHILANTHROPY

Good morning. My name is Robert Bothwell. I am Executive Director of the National Committee for Responsive Philanthropy. The Committee is a coalition of hundreds of local and national organizations working on behalf of minorities, women, the elderly, the disabled, the poor, Vietnam veterans, consumers and those who want healthier and better environments. All are concerned about the very low level of private, philanthropic funding for newer and smaller organizations, especially those that are questioning inequities in our society. The Committee is also very concerned about the accountability of private philanthropy to the public.

I first want to thank the Subcommittee for allowing me to testify today and for your interest in foundations.

THE POTENTIAL OF FOUNDATIONS

Foundations are important and unique institutions. While they account for only about 5 percent of private giving ($3.15 billion of $60.39 billion in 1982), nevertheless, they have tremendous potential for improving our society. One reason for that potential is their pluralism: There are more than 20,000 foundations, each of which can decide differently which types of people and activities should be funded.

A second reason for foundations' potential is their independence: their existence is not dependent on pleasing the voting public or on making a short-term profit. This independence allows them to take the long view, to resist fads, to support promising activities that may be too controversial for the government to undertake or unprofitable for business to support. As the Treasury Department put it in its important 1965 report, foundations have a "special and vital role" in society, which is to "initiate thought and action, experiment with new and untried ventures, dissent from prevailing attitudes and act quickly and flexibly."

IS THIS POTENTIAL BEING REALIZED

A. The funding patterns of foundations nationally

Many foundations have realized their potential for maintaining the vitality and flexibility of our society and its institutions. Numerous organizations that we work with owe at least part of their existence to foundation support. When a group of people come together to discuss the need for a new organization, inevitably they will talk about the potential for getting foundation support to start the new organization. My organization, which receives substantial money from foundations, yet has often been a very vocal critic of foundations, reflects the willingness of some foundations to support groups that are trying new approaches to problems and that are raising hard questions about the fairness of our society.

Unfortunately, foundations that are willing to support organizations that are new or controversial or that actively work for disenfranchised people are few and far between. As Rockefeller Foundation President Richard Lyman put it recently, the foundation world "often talks pluralism and diversity while enacting the herd instinct and conformity." The vast bulk of foundation money goes to well-established, noncontroversial organizations year after year.

This fact, which we think is the most important fact to understand about foundations, will surprise many people. Foundations have an image, one that is fostered by a lot of rhetoric from New Right organizations, of being active crusaders for social change. For those who care to examine them, studies of foundation funding completely undermine this image of foundations as social crusaders.

The most recent is an unpublished study supported by the Twentieth Century Fund. This study examines the grants made between 1955 and 1979 by 47 of the country's 54 largest foundations. (These 47 account for about 35 percent of the assets of all foundations.) The study found that only 3.9 percent of the money given away by these foundations in 1979 benefitted Blacks (a decrease from 5 percent in 1970), 1.4 percent benefitted Hispanics and 0.5 percent benefitted Native Americans.

The study also found that only about one in seven grant dollars given during this 25-year period went to "new grantees," in other words, organizations that the foundations had not supported before. This is a strong indication of most foundations' tendency to continue to fund whatever they have already funded, rather than venturing in new directions.

An indication of most foundations' preference for well-established institutions is the fact that 43.2 percent of foundation money during this period went to colleges or universities while 8.9 percent went to hospitals and 8.4 percent to research institutes.

Many other studies have also uncovered a low level of foundation support for women's causes and minorities. For example, a Ford Foundation-supported study found that only 0.6 percent of foundation funding in 1976 went to projects intended to improve the status of women. The total—$12 million—was less than the amount of support one university received that year from only three foundations. Also, of this money intended to improve the status of women, only 13 percent went to "public activist programs." Most of the $12 million went instead to direct services (33 percent), research (24 percent) or scholarships (18 percent).

In 1981, according to Foundation Center data on 369 mostly large foundations, grants benefitting "women and girls" (a much more inclusive category) totaled 2.9 percent. A 1980 survey of 467 foundations by Women and Foundations/Corporate Philanthropy found that only 2 percent of foundation funds went to "programs that benefit women and girls."

Concerning Hispanics, a Latino Institute study found that only 1 percent of foundation support in 1977 and 1978 benefitted Hispanics, with only about one-half of that going to organizations run by Hispanics. More than half of the money benefitting Hispanics (54 percent) came from one foundation—the Ford Foundation. Again, most of the foundation money benefitting Hispanics supported activities such as education (30 percent) research (12 percent), and health services (10 percent) with only 11 percent going to "community organization and development." An earlier study sponsored by the National Science Foundation found that in 1972-73 Hispanic groups received 0.8 percent of foundation funds.

For Blacks, the Foundation Center reports that in 1981, 2.8 percent of the money given away by 369 mostly large foundations benefitted Blacks.

As meager as these figures are, we believe they overstate the amount of foundation funding for women and minorities because of the foundations that are examined. Most studies of foundations use as a data base information collected by the Foundation Center. The foundations included in this data base voluntarily send information to the Foundation Center. The very act of reporting information about their grant-making shows that these foundations are much more accountable and responsive than the vast majority of foundations, which refuse to voluntarily provide information. We've found that when a foundation is accountable, when it is willing to tell the public what it is doing with its money, it is more likely that this foundation will respond to the newly recognized needs of women, minorities and other groups that lack power in our society.

B. The funding patterns of local foundations

When examining studies of foundation giving in local communities, studies that look at many foundations not included in the Foundation Center data base, even less support to minorities, women and newer groups is discovered. For example, a study by the Portland Committee for Responsive Philanthropy found that only 1 percent of the money given away in 1978-79 by Oregon's 35 largest foundation's went to "women's programs" (compared to 3.9 nationally in 1979 according to the Twentieth Century Fund study of the largest foundations). In Chicago in 1976 only 0.3 percent of funding by 311 foundations went to agencies "designed or controlled by women," according to a study done by a local association of foundations.

Concerning minorities, in Oregon, only 1 percent of grant money went to "programs run by or for racial minorities" (there is no comparable national figure). In Chicago, only 4.4 percent of foundation support went to minority organizations, though Chicago's minority population exceeds 50 percent. In San Diego, only 2.1 percent went to "minority organizations" (San Diego's minority population is 21.4 percent); and only 0.4 went to Hispanic organizations (though Hispanics comprise 13 percent of San Diego's population).

The San Diego study also provides information that shows very dramatically the concentration of foundation funding in a relatively small number of long-established institutions. Twenty-five organizations received 62 percent of the money given away by local foundations. Thirteen of these organizations each received more foundation support than all minority organizations combined. Also, the study found that long-established social service organizations with relatively traditional approaches to social problems received seven times more money than did a broad range of organizations begun since 1965 that have a self-help, community-based approach to social problems.

This concentration of foundation funding in a relatively few, well-established institutions is certainly not confined to San Diego. In Chicago for examole, 70 agencies received 70 percent of the funding from that city's foundations, with one recipient—the University of Chicago—receiving 10 percent, more than double the total received by all minority organizations. In Oregon, 30 institutions received more than half of the state's foundation funding.

As the authors of the Oregon study write: "The point is not that foundations support terrible programs. Rather, the point is that Oregon foundations have channeled their funds into a very few program areas, populations and service philosophies while leaving others virtually untouched."

Which other areas have been ignored? According to the Chicago study, only 1.4 percent of foundation money went to "neighborhood and community development," which the University of Chicago researchers called a "shockingly small amount." Only 0.8 percent went to improve the environment. In Washington, D.C., a 1978 study of 153 foundations found that, of funding that benefitted D.C. residents, 2 percent went to "housing and neighborhood development," 0.25 percent to "consumer affairs," 0.27 percent to "employment/labor," and 0 percent to "natural resources/environment." In Colorado, a study of that state's 25 largest foundations found that, between 1974 and 1976, only 2.7 percent of their grant money went to "nontraditional" organizations, which included those representing minorities, women and the poor as well as groups avocating for older Americans, youth, consumers and the environment.

These figures about foundation giving should put to rest the myth of foundations as crusaders for social justice and social change. Some foundations have made extremely valuable contributions to social justice; unfortunately, most have not.

These figures also contradict the words many foundation officials use to describe their contributions to society. For example, two years ago, the Council on Foundations told Congress that foundations are so valuable because they can "provide venture capital" for "new ideas and new enterprises" in fields like education, health and social services. Yet, as the studies we cited show, very little foundation support goes to the newer organizations that are trying out new ideas. To cite yet one more study that addresses this issue directly, a study of foundation funding in 1976-77 in the field of aging found that, "the criticism that much foundation giving supports existing programs rather than the development of new ideas is substantiated by our findings." The study found that only one of five dollars spent on aging supported innovative programs or changes in policies affecting the aging.

The Council on Foundations also told Congress that foundations are valuable because they can respond to "newly perceived needs." Yet, as numerous studies document, during the past two decades few foundations have responded to the newly-perceived needs of minorities, women, consumers, and the environment.

WHY HAVE MANY FOUNDATIONS NOT REALIZED THEIR POTENTIAL

Why is this? Why have so many foundations been so removed from much of what has been happening in this country during the past 20 years?

One major reason has to do with who makes the decisions about who benefits from foundation money. Unfortunately, most of these people come from a very narrow segment of our population. According to John Nason, whose 1977 study of foundation trustees was supported by the Council on Foundations, foundation trustees are a "self-perpetuating social and economic elite." More recently, the Council on Foundations' "Compensation and Benefits Survey" concluded that, "Foundations are still directed predominantly by white males who are nearing the end of their careers." The survey found that nearly seven of 10 foundation trustees are from business, law or banking. It also found that only 3 percent of foundation trustees are Black (Blacks make up 12 percent of the country's population). However, this 3 percent figure probably represents a significant overstatement of Blacks on foundation boards since the foundations included in the survey were mostly members of the Council of Foundations and they were willing to complete the Council's questionnaire. In Oregon for example, only one of the 35 foundations studied had a minority trustee, while 40 percent had no women trustees. In Colorado only one of 87 trustees of the 25 largest foundations was a minority.

As the Oregon foundation study put it, "if trustees are only drawn from a narrow band of society, then the experiences, skills and interests represented on the board will be equally narrow." The result of this is the kind of funding patterns revealed in the various studies of foundation giving: a relatively few well-established organizations, which often have personal connections with foundation trustees, get most foundation money. Most groups that are newer, that are run mostly by minorities, that are working in poor communities, don't have these personal connections and thus don't get much foundation money.

The relationship between who's on the board and who gets funded was shown clearly in the Latino Institute study of funding for Hispanics. That study found that, of the foundations that gave money to Hispanics, 12 percent had Hispanic employees and/or Hispanic trustees, a far higher percentage than for foundations generally. Noteworthy, there has been a significant increase in women foundation trustees and staff (23 percent of trustees, 26 percent of chief executive officers and almost half of professional staff are women), which we believe is one reason the Twentieth Century Fund study found that funding benefitting females had increased from 0.5 percent in 1965 to 3.1 percent in 1979.

ARE FOUNDATIONS ACCESSIBLE TO THE PUBLIC

But the problem is not simply who sits on foundation boards. The problem is also the attitudes held by most of those people and the actions they take on behalf of their foundations. According to John Nason, most foundation trustees "continue to think of the foundation as the donor's or as 'ours' and resent suggestions for greater accountability, greater accessibility, greater diversity of viewpoint on the board."

We believe accessibility is a key factor, and it is in this area that Congress can mandate changes. Even if you don't personally know a trustee of a foundation it's possible to make your case to that foundation if it is accessible. If there is information about a foundation readily available, you can find out what it has supported in the past, how large its grants are, what its application process is and where to send a proposal. If there is a staff person, you can find out whether the foundation might be interested in your project, plus there is someone who can review your proposal. The Latino Institute study found that 92 percent of the foundations that supported Hispanics had a staff, a far higher proportion than for foundations generally.

Unfortunately, too many foundations do not make information readily available nor do they have even a part-time staff member to interact with the public, nor do they conduct periodic public meetings. Nationally, according to the Council on Foundations, only about 500 of the country's 21,000 foundations publish annual reports. In Oregon, 45 percent of the foundations responding to a questionnaire said it is not important for the public to know about their grant programs. In San Diego, only 2 percent of local foundations publish annual reports.

In 1980, we evaluated the information given to the public by 208 of the country's largest foundations. We found that 30 percent of these foundations refused to provide any information about their activities after as many as six requests. Thirteen of these large foundations did not even have phone numbers. We also found that the information provided by another 30 percent of the 208 foundations did not meet a minimally "acceptable" standard, while only eight of the 208 could be rated excellent in what they disclosed to the public. Those eight are very important, however, because they show that some foundation agree that full disclosure is important and that it can be done.

The finding about phone numbers made us curious: How many foundations don't have phone numbers? In looking through the latest Foundation Directory, which includes brief descriptions of the 3363 largest foundations, we found that 1575 of them did not have a phone number in their listing. Could a grant seeker get a number by calling information? We checked a randomly selected sample of 10 percent of these 1575 foundations, and found that, for 58 percent of these foundations, it was impossible to obtain a phone number, even by asking for the number of the company or bank that houses the foundation. This would translate to 27 percent of all the foundations listed in the Directory. All of these foundations have assets of $1 million or more or make grants exceeding $100,000 a year.

Fortunately, in 1969, Congress mandated that foundations provide basic information to the Internal Revenue Service and that this information be made available to the public. All foundations must file 990 annual reports, which are the basis for most information known about foundations. However, for years we heard complaints that foundations were not including required information in these 990 forms. A small study we did in 1980 confirmed this problem. Then, last year, the General Accounting Office examined foundation annual returns. We think its findings, released last month, are extraordinary. The GAO found that 94 percent of the foundations it studied fail to report all key information required by the IRS. About 70 percent failed to provide complete information on 25 percent or more of the key items of information reviewed by the GAO. One of the most neglected pieces of information concerned the grants made by foundations (79 percent did not completely report this information), which is vital information for grant seekers. Also, nearly a third of the foundations did not include the name and addresses of the foundations' managers, which are also critical to grant seekers.

All of these studies point to one conclusion: too many foundations are not accessible to the public or to grant seekers. This stems from an attitude held by too many people in the foundation world: that foundation officials know everything they need to know to make good funding decisions, and that grant seekers are just not that important. This attitude is expressed very well by Roger Williams, writing in the Rockefeller Foundation Quarterly: "Despite signs of improvements, inquiries among people who have sought grants still turn up one unhappy, frustrating experience after another: phone calls not returned; phones not even answered; proposals not dealt with after their submission was encouraged; foundation officials who are forgetful, flip, arrogant; foundations that are uncommunicative about their goals, procedures, and reasons for rejecting proposals."

One crucial result of this attitude is that the people who run foundations "tend to be the farthest removed from the problems they're addressing," in the words of Bill Dietel of the Rockefeller Brothers Fund. Many foundations simply don't know what is happening in our inner cities, or in rural America, or anyplace else that is not frequented by the mostly wealthy and white people who run most foundations. We don't doubt that foundation people care a lot about our society and want to improve it. But as Emory Bundy, a former trustee of the American Home Foundation put it: "I believe (trustees') intentions are good, but their social horizons are circumscribed by their life experiences."

SHOULD FOUNDATIONS BE ACCESSIBLE AND ACCOUNTABLE

Is there anything wrong with this? Should foundations be accessible to grant seekers? Is being accessible a critical part of foundations' public responsibilities? Why should foundations have public responsibilities?

We and many other people believe that foundations definitely have public responsibilities—foundations must be accountable to the public. The most obvious reason concerns the very significant tax benefits that the public bestows upon foundations--their income is tax exempt; gifts to them are tax deductible. If these tax benefits didn't exist, part of the money foundations control would have been public money. Therefore, this means foundations have an obligation to be accountable to the public in their use of this money, and accountability begins with full disclosure. As conservative columnist James J. Kilpatrick put it, ". . . some public judgment (is necessary) on the desirability of the diversion of otherwise taxable income."

There are many other reasons why foundations should be accountable to the public. One is that foundations are dealing with public needs. As Waldemar Nielson, author of The Big Foundations, writes, "The public has a direct interest in tax-exempt foundations (because) the fields which foundations support, such as education, religion and health, are themselves of direct interest to the public." Alan Pifer, former president of the Carnegie Corporation, expresses essentially the same view: "Foundation funds . . . offer a case when a technically private asset is of such potential value to the nation that it must, perforce, be regarded as a public asset." The Council on Foundations, in its "Policy on Public Information," states, "Foundations exist to facilitate the application of private resources and private initiatives to the public good, and it is this capacity for public benefit which justifies their tax exemption."

Foundations also have a legal obligation to be accountable to the public. This stems from the trust agreement which is the legal basis of foundations. All trust agreements require that a trust's administrators be responsible both to the terms of its charter (presumably the intent of the donor) and to its beneficiaries. In the case of a foundation, the beneficiary is the public. John Nason believes this is the most compelling reason why foundations have responsibilities to the public: "Foundation trustees are servants of the public because the public, whether in broad or limited aspects, are the beneficiaries."

According to the 1970 report of the Peterson Commission on Foundations and Private Philanthropy, a big reason foundations should be accountable is to insure that foundation funds are not misused. The commission quoted Justice Brandeis: "Sunlight can be the most powerful disinfectant." The 1977 annual report of the Committee of the Permanent Charity Fund in Boston said essentially the same thing: "Among the most important guarantees in the long run that a charitable trust's funds will be used in the public interest are the independent auditing and the full disclosure of what it is doing through annual reports to the public . . ."

These concerns about the possible misuse of foundation funds suggest yet one more reason that foundations should be publicly accountable. In the words of Ford Foundation President Franklin Thomas, "The way you really enjoy your privacy as a foundation, ultimately, is to be accountable for what you do." Forty years ago former Carnegie Corporation President Frederic Keppel explained why: "The public is most likely to become suspicious when it is uninformed . . ."

One of the most important reasons for a foundation to be accountable to the public is that doing so will help it make better grants. Part of this is that the very process of being accountable can be helpful to a foundation. In trying effectively to communicate its purpose to the public, a foundation often will have to rethink its purpose. And as the 1979 annual report of the Twentieth Century Fund states, "A conscientious and thorough reevaluation will . . . serve to redirect and revitalize foundation programs . . ." Periodic public accountings, whether by preparing annual reports or holding public meetings, can involve foundations in a process of self-evaluation that is vital to growth and self-renewal.

Also, being accountable to the public can help expose the foundation to parts of the public that it had overlooked. According to Bill Bondurant, Director of the Babcock Foundation, holding a public meeting allowed the foundation to "hear from voices we wouldn't ordinarily hear from . . ." He said that it caused the Foundation to support at least one relatively new organization—the Brown Lung Association.

Both the Council on Foundations and the prestigious Filer Commission on Private Philanthropy and Public Needs agree that foundations should be accountable and accessible, both by disclosing information about their activities and by broadening their boards. The Filer Commission, which spent three years studying philanthropy in the early 1970s, recommended that foundations (and other larger charities) "make readily available detailed annual reports on their finances, programs and priorities," and that they hold annual public meetings. The Commission also recommended that foundations "recognize an obligation to be responsive to changing viewpoints and emerging needs and that they take steps such as broadening their boards and staffs to insure that they are responsive."

The Council on Foundations, in a 1973 official policy statement on grant-making, stated that, "Too often foundations have proved inaccessible and their decision-making processes cloaked in secrecy." The Council believes that, "Out of the public trust vested in foundations grows the need to accept the principle of full disclosure. . . ." The Council also stated that, "diversified boards and staffs will tend to insure the sensitivity of foundations to the needs of segments of the society who have too often been denied adequate voice and representation."

RECOMMENDATIONS TO IMPROVE ACCOUNTABILITY AND ACCESSIBILITY

Regarding written accountability, during the past decade there have been improvements in the information available to the public about foundations, thanks mainly to Congress (which passed the Tax Reform Act of 1969) and the Foundation Center. However, as we have explained, there are still serious inadequacies.

One inadequacy concerns the incomplete reporting of information to the IRS which the recent General Accounting Office study documented. We urge this Subcommittee to join the Subcommittee on Commerce, Consumer and Monetary Affairs in urging the IRS to better enforce existing requirements for disclosure of information by foundations.

The IRS recently required that foundations disclose several additional items of information, such as application deadlines. These additional requirements were needed. There is one more item of information that should be disclosed: foundations should be required to indicate the racial/ethnic and sexual composition of their boards, staffs and managers. This information would allow Congress and the public to monitor how well foundations are moving to reflect the great diversity of this country.

We also urge Congress to take steps to deal with another problem involving information about foundations—its accessibility. The Foundation Center has done an excellent job of getting information to grant-seekers through the Center's extensive network of libraries. But there is twofold problem: there are still many people who live a long distance from one of the Center's collections, and most of these collections only have 990 annual reports for local foundations. We recommend that Congress require all larger foundations (with assets exceeding $1 million or grants of $100,000 or more) to make simple annual reports available to the public on request within 60 days at cost (not to exceed $1). At a minimum these reports could be simple copies of their 990PFs, or should contain key information from the 990PFs. As the practice of making such reports available to the public becomes better accepted, we expect foundations to expand the content of these reports to include the additional important information that many foundations now include routinely in the annual reports they voluntarily make available to the public.

Also, larger foundations should be required to advertise the availability of their annual reports in the largest circulation newspaper in their communities. Currently, foundations are required to advertise the availability of their reports, but many do so in small circulation papers read primarily by lawyers. By requiring foundations to advertise in a paper read by the general public, a lot of people would learn for the first time about local foundations.

We also recommend that larger foundations be required to hold annual public meetings of their trustees. We believe this would be a significant step toward greater interaction between the public and foundations.

We believe these modest changes will not only in themselves improve foundation's openness and accountability, but that they will also help stimulate much more concern within the foundation world about the desirability of openness and the need to be accountable to the public. As we've explained, we believe that when foundations become more open and accountable, they will become more responsive to less-established organizations and newly-perceived needs.

OTHER FACTORS THAT IMPEDE FOUNDATIONS' RESPONSIVENESS

There are at least two other factors that contribute to the reluctance of foundations to support many newer, smaller, sometimes controversial organizations.

A. Expenditure responsibility

One factor involves the requirement that foundations comply with detailed "expenditure responsibility" requirements when they make grants to organizations that do not have public charity status, which many newer organizations do not have. As Congressman Conable said when introducing a bill that would eliminate this requirement (H.R. 3043, sponsored also by Congressmen Frenzel, Shannon & Gephardt), "this administrative burden discourages foundations from making many small but worthwhile grants."

When foundations are considering making a grant to a non-public charity, they must conduct a pre-grant investigation of the prospective grantee, write a formal grant agreement, obtain periodic accountings from the grantee, and file an annual report with the IRS on the use of grant funds. Now much of this seems reasonable. And many foundations routinely undertake the first three tasks even with grantees that are public charities.

But the last requirement—that each such grant, no matter how small, must be reported in detail to IRS—has had a tremendous chilling effect. Many foundations are extremely unwilling to risk an IRS audit of their expenditure responsibility grants.

Understand that foundation grants for 501(c)(3) organizations, particularly when the grant documents clearly state the "charitable, educational, research, scientific" or other appropriate purposes of the grants, are subject to no such reporting requirement and IRS scrutiny unless great controversy attaches to a grant or grantee.

Particularly hard hit by the expenditure responsibility law are grassroots organizations, especially newer and smaller ones, such as neighborhood organizations, rape crisis centers and self-help groups for the disabled. Their purposes are just as legitimate as those of the large, well-established charities and universities which normally receive foundation monies; they simply don't have the resources or expertise needed to go through the process of obtaining IRS recognition as a public charity. Ironically, if they could get a small "seed" grant from a foundation, many would be able to go through that process.

A 1980 survey by the Council on Foundations revealed that, "Before 1970, over one-third (of the 271 reporting foundations) made the type of grants that now require expenditure responsibility. Thirty percent (30 percent) of those foundations now have a policy against making such grants." Overall, "About 40 percent of all (271) responding foundations have policies that prevent them from making grants that require expenditure responsibility." These figures show the law's chilling effect, but they don't reveal that many other foundations also do not make expenditure responsibility grants even though they have no formal policy.

We recommend that Congress revise the current law so that foundations do not need to report grants under $5,000 to organizations not recognized as public charities, as long as total grants to a single grantee do not exceed $5,000 in a given year. Except for a lesser threshhold amount, our recommendation is exactly as that contained in HR 3043 introduced by Rep. Conable, et al and by the Council on Foundations.

Such a change would not in any way affect the explicit statutory requirement that every foundation grant, large or small, must support a recognized charitable, educational, research, scientific or other approved activity.

And, as Rep. Conable said when introducing HR 3043: "Nor would the amendment affect strict IRS requirements that foundations making grants to non-exempt grantees make every reasonable effort, including requiring periodic reports from grantees, to ensure that every grant dollar is spent for the designated charitable purpose."

B. Limits on foundations in supporting grantee lobbying

Another factor that impedes foundation support for potentially controversial organizations is the strict prohibition (included in the TRA of 1969) on foundation support for propaganda or other attempts to influence legislation. There are strong tax penalties on foundations and foundation managers who knowingly violate this prohibition (Sect. 4945 of the Internal Revenue Code).

While generally understood to prohibit foundations from directly engaging in such activities, this action also has been interpreted by some foundations to absolutely prohibit them from making grants which may involve some lobbying. Often they expressly prohibit grantees from using granted funds to carry on propaganda or otherwise to attempt to influence legislation.

Universities and other large, well-established nonprofit organizations can easily accept these restrictions, because they have adequate funds from other sources to enable them to lobby, but smaller organizations do not. For many organizations, foundation grants may make up a major part of their budgets. Either they take the foundation seriously which says they cannot use the funds for lobbying or they use some of the funds for lobbying knowing they run the risk of foundation retribution if they should be found out.

However, public charities have always been permitted to do some lobbying. Moreover, the Tax Reform Act of 1976 expanded the amount of lobbying charities can do—up to 30 percent of total expenditures for smaller organizations.

The problem, thus, is that the law is confusing as to whether or not foundations can support legitimate lobbying by public charities. Currently an IRS letter ruling provides guidance. But IRS has not made this into a revenue ruling, which has more force, and thus the situation remains very murky. Timorous foundation officials afraid of running afoul of IRS, and public charity leaders ignorant of the IRS letter ruling, therefore, combine to provide us with less venturesome foundation funding.

We recommend that Section 4945 should be amended to remedy this situation.

THE HEALTH OF FOUNDATIONS

While we are often critical of foundations, we also strongly support their continued existence, as we stated in our introduction. We are thus concerned about reports that the birthrate of foundations is declining. However, to paraphrase W. C. Fields, we think reports of the death of foundations may be greatly exaggerated.

A. Birthrate of new foundations and its relationship to the TRA of 1969

It has been suggested by some people that the birthrate of new foundations has declined because donors do not have as much tax incentive to give to private foundations as to public foundations by the Tax Reform Act of 1969, such as the requirement that foundations dispose of excess business holdings.

Before Congress accepts this argument, however, it needs to examine available statistics.

According to Foundation Center data, only 40 foundations with $10 million or more in assets were established during 1970–1979.[1] But, according to a recent Internal Revenue Service publication, "The number of foundations with assets of $10 million or more increased from 354 to 490 (between 1974 and 1979) . . .Therefore, these data do not support the position that foundations are a dying breed." [2] Now to some extent these figures are not comparable (since the former only concerns the establishment of new foundations, while the latter also includes foundations that increased in size). The Foundation Center data also shows that more foundations with $10 million or more in assets were established in the 1960s (78) than in the 1970s (40). But, surprisingly, the decrease in the number of new larger foundations did not begin in the 1970s: more large foundations were established in the 1950s (160) and the 1940s (142) than in the 1960s (78). Obviously, the decline in the 1960s had nothing to do with the TRA of 1969.

But even if the birthrate of foundations declined during the 1970s, would not the decline indicate that the 1969 laws were successful in eliminating the establishment of foundations which grossly abuse their tax-exempt privileges? Foundations like this clearly existed prior to 1969, and the TRA of 1969 was intended to eliminate them from the foundation world.

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[1] Patricia Read, Foundations Today, 1982, the Foundation Center, New York, 1982.

[2] Thomas B. Peska, "An Examination of Private Foundations for 1979," Statistics of Income Bulletin, vol. 2, No. 2, fall 1982, Department of Treasury, Internal Revenue Service, p. 10.

In summary, before the regulatory controls enacted in 1969 are weakened, we need to have better data on exactly what has been happening in the foundation world, and why. There is a study of the birthrate of foundations beginning at Yale, which will provide some of this information. At this time it is simply not clear that we have a birthrate problem. Maybe the TRA of 1969 has acted as an effective birth control program preventing undesirable, unwanted foundations, which would have, by their financial abuses, sullied the reputations of the responsible foundations as happened in the 1960s. Careful study is needed before changing the regulatory controls enacted in 1969.

B. Lesser tax incentives for gifts to private foundations

If, however, Congress decides that foundations should receive more of the tax benefits received by public charities, then we strongly urge that any increase in tax incentive for gifts to private foundations be accompanied by substantially increased public accountability requirements. After all, increases in tax incentives mean fewer dollars for the public treasury through income or estate taxes. The tradeoff is clear.

We recommend the following additional requirements in exchange for better tax incentives to create private foundations:

(1) Must meet all the requirements for improved accountability and accessibility recommended previously (pp. 9-10);

(2) Must not pay excessive trustee or staff compensation;

(3) Must have a diversified board of directors including minorities, women and others for whom the courts have ruled in discrimination cases;

(4) Must have diversified assets, rather than assets concentrated in one company; and

(5) Must pay out at a rate substantially higher than the minimum requirement of 5 percent of assets.

C. Excess business holdings

And, if Congress decides that the excess business holdings requirement has been too discouraging for some who may have wanted to create new foundations, then we recommend the Congress accept The MacArthur Foundation's proposal. That proposal would keep the current law, but allow the Secretary of Treasury to extend the period of time during which foundations must dispose of excess business holdings acquired after 1969.

D. Payout rate

According to some people, another factor that has reduced the health of foundations is the requirement that each year they must pay out a certain percentage of their assets. Two years ago, foundations successfully argued that the then existing requirement (5 percent of assets plus all income greater than 5 percent) in combination with runaway inflation was causing a significant decease in foundation assets. Congress thus lowered the payout rate to a straight 5 percent of assets.

However, as with data concerning the birthrate of foundations, we have questions about data concerning the declining assets of foundations. We also have concerns about the effect of a lower payout rate on the recipients of foundation grants, especially now that many charities are struggling because of the severe cuts in government funding. Because we believe the payout rate question will come up again, we want to review the data and offer our recommendation.

The justification for changing the payout rate in 1981 was that inflation and the payout requirement were combining to wipe out foundation assets. If one looked only at how 1972 data compared to more recent data, one would have to agree that foundation assets were declining (that is, if we conveniently forget how high the stock market was in 1972, and how overvalued were so many stocks). If one examines Foundation Center data over a longer period of time, however, one will find that foundation assets declined only 10 percent between 1965 and 1979 (in constant dollar terms). Also, foundations assets did not decline at all between 1975 and 1979 (the most recent years for which we have data).[3]

Therefore, we believe there was little justification for lowering the payout rate in 1981.

Also, we are very concerned that the lower payout rate is hurting nonprofits. The Urban Institute estimates that because of Federal budget cuts, $120 billion less will be available during fiscal years 1982-85 in program areas of principal concern to nonprofits and that $30 billion of that will be a direct loss of nonprofit revenue. While foundations can't begin to make up for this revenue shortfall, nevertheless, a higher payout rate could help. We recommend a payout rate of 5 percent plus one-half of all income greater than 5 percent. If foundation income and assets today are similar today to what they were in 1979, then our proposed payout rate would increase the income of nonprofits by $100–$350 million annually.[4]

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[3] Patricia Reed, Foundations Today, 1982, The Foundation Center, New York, 1982, Table 13.

SUMMARY OF RECOMMENDATIONS

Once again I want to reiterate: the National Committee for Responsive Philanthropy believes that private foundations are important and unique institutions. They add a very important dimension in private giving for the benefit of public good in our country. Their great diversity and independence means there are greater possibilities for financial support for new, untried, struggling, and sometimes controversial nonprofit organizations than if sources of potential support for nonprofts were limited, say, to government, corporations and United Ways.

But, also as I have indicated, while many foundations are fully accessible and accountable to the public, much beyond what the law requires, there are far many more who hardly begin to live up to their responsibilities as quasi-public institutions.

Following is a summary of our recommendations, therefore, to improve foundations' accessibility and accountability.

(1) Following the GAO report's recommendations, Congress should urge the IRS to better enforce existing requirements for disclosure of information by private foundations.

(2) Congress should require foundations to indicate the racial/ethnic and sexual composition of their boards, staffs and managers in their required 990PF annual reports.

(3) Congress should require all larger foundations (with assets exceeding $1 million or grants of $100,000 or more) to make simple annual reports available to the public on request within 60 days at cost (not to exceed $1). These reports at a minimum could be simple copies of their 990PFs or should contain key information from the 990PFs.

(4) Congress should require larger foundations to advertise the availability of their annual reports in the largest circulation newspaper in their communities.

(5) Congress should require all larger foundations to hold annual public meetings of their trustees.

Additionally, if Congress decides it wants to encourage more growth in new foundations by changing key provisions of the Tax Reform Act of 1969, we recommend the following.

(6) If Congress decides to improve tax incentives for gifts to private foundations, to make them more comparable to incentives for gifts to public charities, then Congress should require the select foundations which want to utilize the expanded tax incentives to comply with the following: (a) All of the above recommendations; (b) No excessive trustee or staff compensation; (c) Diversified board of trustees, including minorities, women, and others for whom the courts have ruled in discrimination cases; (d) Diversified assets, rather than assets concentrated in one company; and (e) A payout rate substantially higher than the minimum requirement of 5 percent of assets.

(7) If Congress decides to modify the excess business holdings requirements, then Congress should accept the MacArthur Foundation's proposal, which would keep the current law, but allow the Secretary of Treasury to extend the period of time during which foundations must dispose of excess business holdings acquired after 1969.

Finally, in order to further improve foundations responsiveness to less established organizations and newly perceived needs, we recommend the following.

(8) Congress should revise the current "expenditure responsibility" law so that foundations do not need to report to the IRS about grants under $5,000 to organizations not recognized as public charities, as long as total grants to a single grantee do not exceed $5,000 in a given year.

(9) Congress should amend Section 4945 of the Internal Revenue Code to make clear that foundations may make grants to public charities which may involve lobbying permitted under the Tax Reform Act of 1976.

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[4] The higher figure is based on Thomas B. Petsha's analysis and conclusions in "An Examination of Private Foundations for 1979," Statistics of Income Bulletin, the Department of Treasury-Internal Revenue Service, Vol. 2, No. 2, Fall 1982, p. 12.

Chairman **Rangel**. Mr. Nielsen, would you like to wind up for this panel?

Mr. **Nielsen**. Thank you, Mr. Chairman.

STATEMENT OF WALDEMAR NIELSEN, CONSULTANT AND AUTHOR, NEW YORK, N.Y.

Mr. **Nielsen**. My name is Waldemar Nielsen. I live in New York City. I am a writer. I have been a foundation executive and adviser to a number of donors and foundations.

I have the very curious taste of being fascinated by these quite special and distinctive American creatures: Private philanthropic foundations.

I share very much the feelings of Brian O'Connell about the importance of trying to maximize the freedom and independence of foundations within some clear general framework of rules of accountability. I also share Mr. Bothwell's concern about the fact that foundations are only minimally providing the public with the information that is necessary for them to fulfill the full spirit of their obligations of accountability.

What I thought I might do to be helpful to your deliberations is, therefore, to confine my comments to a few points and to make a specific suggestion for your consideration.

First with regard to the 1969 Tax Act: There have been comments and questions to the point that it might have been an overreaction, an emotional response to the circumstances of a particular time. I would like to raise one small cheer for the Congress in this particular action. There were real and serious abuses at that time. Philanthropy was undermining its own standing and prestige and credibility with the American public because those abuses had continued for a long period of time.

I think the 1969 Tax Act was a remarkably well conceived and effective piece of legislation. It focused on the principal problems, due, in part, I believe, to the excellent report that the Treasury had issued in 1965.

It prescribed, on the whole, remedies that by the experience of some 13 years now have worked really quite well.

There are a few patches and rectifications which I daresay are in order at this time. The one that impresses me most from my studies of foundations is the need to eliminate the present discriminatory treatment between grantmaking and operating foundations, or publically supported foundations.

As Mr. Conable mentioned earlier in these hearings today, it is not clear to him, and it is not at all clear to me what the rationale for this differentiation in the law may be between operating and grantmaking foundations.

Grantmaking foundations have their own special potentialities. They also obviously make their own important contributions to the society.

The difference in the tax treatment, however, of donors to these two different kinds of institutions, it seems to me, is not justified either in theory or in practice.

One very important consequence of the 1969 Tax Act over and beyond its particular provisions was the fact that it stimulated a very important series of developments within the field of philanthropy itself to improve the effectiveness, the accountability, responsibility, diversity even, of philanthropy. These past 14 years have been a particularly interesting vigorous, fruitful, creative period in the field of philanthropy, catalyzed, I believe, in real degree by the drama of the 1969 Tax Act and hearings that preceded it.

I think the Council on Foundations has now vigorous leadership and an able staff and is doing very important work. I think Foundation News, their publication, has passed from being just another trade association house organ, to being a credible and constantly improving professional journal. I think the regional association of grantmakers which have been created throughout the United States in recent years are again a very important contribution.

I think the Committee on Responsive Philanthropy that Mr. Bothwell heads has been a very valuable gadfly in stimulating creativity and responsiveness on the part of foundations.

So, this has been a period of real ferment, real development, probably the most active and productive of that kind anytime in the history of American philanthropy.

I would sum up the situation, then, as this: I think, on the whole, Congress has done most of what the Congress can do by legislation and regulation to stimulate and improve American philanthropy. There are, however, a few particular modifications that I trust you will consider.

I was very interested in the Treasury Department's openness to some of those this morning. But, on the whole, Congress has done what government can do. It seems to me the great problems now—if for example we are going to address the problems of sluggishness of management, ineffectiveness of programs, unresponsiveness to particular groups of applicants for help, perhaps a slowness or an indifference to respond to some of the changing needs of our society—those are problems that Government cannot and should not attempt to solve by regulation.

But what might Congress do? The suggestion I would submit to you for your consideration is this: As has been pointed out earlier today, the present 2-percent excise tax on foundations is producing something on the order of $100 million a year of revenue. I would guess that something around $10 or $15 million of that is actually spent on the oversight of foundations, and perhaps another $20 million is spent on the oversight of nonprofit organizations of all kinds.

It seems to me that Congress might consider utilizing perhaps $10 or $15 million a year of that excess income, so to speak, of the 2-percent fee to finance a new national endowment for the advancement of philanthropy and the nonprofit sector that might be organized and operated somewhat in the fashion of the National Endowment for the Arts or the Humanities, the purpose of its outlays being to help fill the great void of information and analysis that exists in American life with respect not only to private foundations, but to this whole enormous, vital sector of nonprofit agencies of all kinds.

It is a remarkable fact that if you go to the Library of Congress, for example, you can find multitudes of books on the government sector and on the private economic sector of our society. But all the books that you will find on the nonprofit sector as a whole, you almost literally can put in a child's knapsack.

The great need for more facts has been evident once again in these discussions this morning. Even the question of whether the 1969 Tax Act has been an impediment to the creation of new foundations is a matter on which factual data is inadequate.

So, my suggestion, Mr. Chairman, would be that if some portion of the excess funds now being received by the Treasury from the 2-percent excise fee could be used through a public-private endowment structure of some kind, to help fill these great needs for information about the nonprofit sector, including philanthropy, to give such governmental aid and encouragement I believe would be consistent with the spirit of freedom and diversity in philanthropy.

Thank you.

Chairman **Rangel**. Thank you, Mr. Nielsen.

Mr. Thomas?

Mr. **Thomas**. Thank you, Mr. Chairman.

I want to compliment Mr. O'Connell on his testimony, and Mr. Bothwell, as well.

Mr. Nielsen, just a couple of questions: First of all, there is no such thing as excess income.

Mr. **Nielsen**. I had imaginary quotes around that.

Mr. **Thomas**. Your thesis is slightly different from some of those who have testified today along the lines that creativity was actually promoted by the 1969 act.

I feel that there was probably an interaction between what occurred in terms of disclosure and the need to become more professional on the part of foundations, and the fact that the Tax Act occurred in 1969 on the edge of the decade of the 1970's. Maybe the concerns for which Mr. Bothwell is looking for money from various foundations were, in large part, focused within the decade of the 1970's. It was a combination of the two; from my position, probably more the decade of the seventies that promoted this diversity than the Tax Act.

But you indicated one prohibition of 3043 you would support was the removal of the difference between the types of giving.

Are you supportive generally of the other aspects of H.R. 3043? Are you familiar with them?

Mr. **Nielsen**. This is Mr. Conable's bill?

Mr. **Thomas**. Yes; having to do with disqualified persons and the other areas of change.

Mr. **Nielsen**. I have read it. On the whole, it seems to me a very constructive and very useful bill. I am really not competent from memory to comment on its various specific provisions.

But it is clearly a carefully worked out, constructive bill based, as I know, on extensive consultation with people throughout the field.

So, on the whole, I am strongly supportive of it.

Mr. **Thomas**. It would be a positive contribution and would not detract from the basic purposes of the 1969 act, in your opinion?

Mr. **Nielsen**. I think not. In fact, I think it would perform some very important adjustments and rectifications in the 1969 act.

Mr. **Thomas**. Mr. Bothwell, do you have a reaction to that?

Mr. **Bothwell**. I raise again the question of the birthrate of foundations. I would like to suggest, that according to Foundation Center data, only about 40 foundations with $10 million or more in assets were created in the 1970's. But, according to IRS data, the number of foundations with assets over $10 million increased from 354 to 490 between only 1974 and 1979. Therefore, according to the author of an article using the IRS data, "These data do not support the position that foundations are a dying breed." Yet, I think the fundamental, most important part of Mr. Conable's bill has to do with the need to create new foundations, because he believes they are not being created nowadays in the same numbers as in the past. Therefore, I would again urge the subcommittee to look not only at the data we cite, but also at all other available data before making such a conclusion.

Mr. **Thomas**. Mr. O'Connell, what is your reaction to a national endowment for philanthropy?

Mr. **O'Connell**. I was afraid you might ask me that. I could not agree more that there is a need for such a fund. I guess I would go at it differently, though. First, I would remove the excise tax altogether and let that money flow through the diversity of the individual foundations.

I would not want this sector, which must, among all sectors be independent, to be that dependent on government and a government-funded and, I am sure, government-controlled agency.

Therefore, I oppose it as I have just heard it, though I support it totally if we can—and Mr. Nielsen and I have discussed it—if we can get it going wholly in this independent private sector.

Mr. **Thomas**. Thank you very much, Mr. Chairman.

Thank you.

Chairman **Rangel**. I am going through Mr. Bothwell's testimony. Basically, throughout, he is saying that there are very few minorities that serve on boards of these foundations and that, generally speaking, the recipients of the grants reflect the composition of those boards, and that the result has been that an infinitesimal amount seems to go to blacks, Hispanics, and other minorities.

Would any of the other two panelists care to comment on it? First, Mr. Bothwell, is that a fairly accurate summary of your testimony?

Mr. **Nielsen**. I might venture my view. I believe that the committee, as I heard the various witnesses this morning, received a slightly romanticized version of what American philanthropy is. As I have indicated, I strongly believe in this institution of American life. However, the number of foundations that are genuinely creative, professionally competent, willing to innovate, willing to take even limited risks of failure in their experimental ventures, are really very few.

The great bulk of American foundations do entirely useful but quite conventional things. They pass money on to traditional, generally middle-of-the-road charities and operating social welfare institutions. That is by no means a wicked thing to do, but it is something less than the keen, creative, flexible image that was conveyed by some of the information you were given this morning.

Part of that, Mr. Chairman, I think, is, due to a strong bias in the general pattern of distribution of grants toward older, more familiar, more established institutions. And the groups that have not shared fully in the rewards of American society in the past are therefore at a disadvantage, Hispanics and blacks and emerging needs are not yet well served through established charitable nonprofit institutions which are more attuned to clientele and needs of an earlier time.

So, there are problems in this field. I am not one who feels that there should be any kind of forced or compulsory diversification of their grantmaking by the hand of Government; but I do believe that an accurate picture of the biases and imbalances which exist is something that is seldom presented.

Chairman RANGEL. Do any of the panelists care to comment on that observation?

Mr. BOTHWELL. Just on the ending part, Mr. Chairman. In our recommendations, which I did not detail, we relied on basically three things.

One was to improve the flow of information to people who generally just don't have any contact with foundations, and that is the only way they can get the kind of information necessary to know whether or not they can even begin to apply and seek grants.

Another set of recommendations had to do with having foundations start to report at least something about who is on their boards. Give us some idea of the racial, ethnic, and sexual composition of the boards, to see: Are foundations moving to reflect the greater diversity of this country, or are they remaining essentially bastions of elderly white males?

Before telling about my third set of recommendations I might stress that both the first sets of recommendations do not deal at all—and I agree with Mr. Nielsen on this—with any attempt at having Government tell foundations how to spend their money.

The third set concerns the removal of a couple impediments. One, the expenditure responsibility impediment which prohibits flow of grant money to small grassroots organizations, and the second, which I did not mention, but which is in our complete testimony, is to conform present law on foundations in section 4945 of the Internal Revenue Code to the Tax Reform Act of 1976, which explicitly and clearly allowed a certain percentage of expenditures for grantees and all 501(c)(3) nonprofits to lobby.

We have a confusion in the law about this right now. And grantees and foundations have to rely upon an IRS letter ruling, which is not nearly as comfortable as something in a law would be.

Mr. O'CONNELL. Mr. Chairman, it is important to speak to this point, though it strikes me as the typical irony and typical contradiction that the question is addressed to three white males, as usual. As best then within that limitation, let me add my concern and dismay with the small proportion of women and minorities who serve on the boards of private foundations. I don't believe that we can get at that solution by legislation. And in the case of foundations, I don't believe we should. I see progress being made.

Indeed, I would agree that the kind of public reporting that I hear all three of us discussing will at least begin to make the fact clear and, hopefully, the shame of it, also.

Chairman RANGEL. Mr. Thomas?

Mr. THOMAS. Mr. O'Connell, you would not object to a reporting requirement, would you?

Mr. O'CONNELL. No, I would not.

Mr. THOMAS. I think that was basically Mr. Bothwell's point.

Mr. BOTHWELL. Yes, sir.

Mr. THOMAS. Just to get an idea of what the makeup looks like, obviously no required adjustments. I do want to back you on your point that Mr. Bothwell has two of the three characteristics about which you were concerned, so it is not necessarily so. But clearly a better understanding of who is on the board can lead to pressures brought about through the private sector to enable some changes to take place, so you would not object to a reporting procedure.

Thank you, Mr. Chairman.

Chairman RANGEL. Well, it seems like the testimony went further, saying that it is hard even to find the telephone numbers, much less who is on the board. Is that your testimony? That it is difficult to find out where these foundations are located, the telephone numbers, the offices?

Mr. BOTHWELL. Yes, sir. We took a look at the foundation directory—published by the foundation center—which contains about 3,400 of the largest foundations. Almost 1,600, first of all, had no listing for a phone number. Well, we know that the foundation center does a very good job of getting data. But sometimes they cannot get everything. So, we then took a 10-percent random sample of the foundations that have no phone number, and we called information in the foundations' hometowns, as they were listed in the directory. Where there was no listing for the foundation, we went further and asked, is it listed through the bank or corporation that the directory had listed as a c/o address? The result was that in 59 percent of those cases where there was not a phone number listed in the directory, we still could not come up with one, which translates to about one-quarter of all the directory foundations—and these are the largest foundations in the country holding 85 percent of the assets.

Yes; so—you are quite right, Mr. Chairman—getting through to foundations is indeed very difficult for some. For many. However, I also want to stress that there are also many foundations which are superb and excellent in publishing essential information, in publishing phone numbers and, in fact, being accessible to inquiries, and so on. But overall access is a serious problem.

Mr. O'CONNELL. I wonder if I might comment just so that the impression not be given that these larger foundations, themselves, are unavailable and inaccessible. The foundation directory lists, as Mr. Bothwell has indicated, some 3,000 foundations. About 85 percent would be described as very small. While you were out, sir, I mentioned that their median grant is $5,000. For the most part, these are foundations that do not have offices. They are simply a family's means of—their preferred way of structuring their giving.

So, while I agree totally with Mr. Bothwell about the need for public reporting, I don't believe the fact that you can't get an address or a phone number for most of the foundations in the foundation directory is indicative that they are hiding or inaccessible.

Chairman RANGEL. Let me hear from you again because I see a sharp conflict here. I am not trying to——

Mr. **Bothwell.** Just a quick rejoinder.

All the foundations in the directory, which are 15 percent of the total 22,000, all have $1 million in assets or make grants of $100,000 or more.

Chairman **Rangel.** I thought you said that.

Mr. **Bothwell.** That sounds large enough that they ought to have a greater public accountability than simply filing a form with IRS.

Chairman **Rangel.** What I am saying is if what you say is true in terms of medium-sized foundations not being listed, then I would think that there is a reason why and that is they don't want people to know where they are. So it is not just as simple as knowing who is on the board because if you don't know where they are located, you are never going to find out who is on the board.

When you get to the board, what your general objections are is that while, generally speaking, the work of the foundations is outstanding, it normally reflects the membership of the boards or at least those people that are making the decisions as to who would get the grants and if we don't find who they are—these people sitting on the boards—the conclusion is that then very little of the money gets involved in newer community-based type of work. All of you are saying that, while of course legislation should not be used to reach that, we should have more public reports without identifying bias and color of the members of the board, and that would clear it up in the long run.

I think that is generally a summary of what has been said.

Mr. **Nielsen.** Mr. Chairman, this particular matter we are discussing is a perfect example of why I feel some additional resources have to be made available to develop information about various aspects of philanthropy and the nonprofit sector. Here we are trying to assess important public policy choices and we simply do not have the facts available on which to base reasonable judgments. I wish I could share Mr. O'Connell's optimism that if the 2-percent excise fee were removed philanthropy would then be prepared to fund adequate studies and data gathering about its activities and about the nonprofit sector.

The entire record of American philanthropy is that the thing they are least disposed to finance is data gathering about analysis of their own institutions.

I agree that there can be a problem of Government control, undue Government influence, in distribution of such funds if the source of the funding is Government. But I dare say that philanthropy is not a more sensitive area than the arts or the humanities in American life. And the invention of the endowments has worked out to provide real protection against the Government danger, so to speak, to the freedom of the arts and humanities.

I think with a little imagination we can devise in this field a mechanism for providing an absolutely essential body of information with just a fraction of the funds that are currently not being used for oversight purposes that are collected from the 2-percent fee, and I do believe that this would be a great contribution, great stimulus, to further intelligent discussion and free processes for the stimulation and improvement and extension of philanthropy and nonprofit activities in American life.

Chairman **Rangel**. Yes.

Mr. **Bothwell**. One additional thought, our national committee has at times entertained the idea of what it would be like if there was legislation that helped direct foundation money in certain directions. But I would have to tell you honestly that our committee's board of directors, which is half women and at least a third to 40-percent minority, has decided it would not be viable.

Let me give you one example. Recently, this year, as events change around in the country, events affecting legislation and other matters, the administration proposed a set of regulations for OMB Circular A-122 which in effect would have made it all but impossible for small nonprofit organizations which receive any Government contract or grant money to engage in any lobbying or attempts to influence legislation or even advocacy on any matter of public policy, even though using only private moneys for these activities.

The administration is carrying this further now by attempting to cut out legal defense funds that advocate on behalf of women and minorities from the combined Federal campaign, the $100 million a year public charity drive. We would hate to see those kinds of possibilities come home to rest in restrictions about the money that foundations can give. We would much rather see the wide open possibilities for support of all manner of activities that foundations currently enjoy, with the hope we can increase contacts between foundations and our constituency through public meetings and better reporting and whatever, and that this would ultimately lead to an increase in funds for the kinds of organizations about which I spoke.

Chairman **Rangel**. Well, I don't think you have to worry about any mandatory set-asides. I was trying to get the administration to say whether or not they would be prepared to support legislation that would attempt to direct foundations in the areas where the Federal Government feels it is not a Federal function. I don't know why the idea of a set-aside in legislation would be so repugnant. Of course, I am not suggesting it, but all of you volunteered this. I never asked anybody whether they thought legislation should be necessary but was legislation, use of legislation considered—it was discussed and rejected.

I don't know who brought it up. In any event all of you are saying that at the very least there should be more publication of who sits on foundation boards, how the decision is made and where the money goes. And you are saying the excise tax could be used to fund more public information. You don't believe it would be an affront to the foundations if an information-gathering service was attempted to be rendered by the Federal Government?

Mr. **Nielsen**. Mr. Chairman, I don't have a sense of what the foundation community might feel about this.

Chairman **Rangel**. We will find out, I think.

We have heard some comments of Mr. Joseph. Would you care to comment on anything said, Mr. Joseph?

Mr. **Joseph**. One thing I would like to make clear, Mr. Chairman. I, too, agree that the foundation field needs internal critics and the criticism you have heard here has been supported by foundations themselves. I think it is very, very helpful to have that.

I would just add one thing in this regard. You asked a question about minority composition of boards of directors and that sort of thing. We have at the Council on Foundations done a study of minority composition of trustees and boards and I have had conversations with some staff and members who have asked about that and so I would simply just make more clear what we found.

We did a survey which included about 44 percent of the assets of the field, and we found that on boards of trustees there were 96-percent white and 4-percent minority.

On chief executive officers, less than 1-percent minority. Ninety-nine-percent white.

On professionals, 91-percent white, 9-percent minorities.

Even in support staff it was about 83-percent white and 17-percent minorities. So that I would suggest that the concern expressed here is an appropriate concern. I have always shared that concern myself. The council shares that concern, and that is why we have been encouraging foundations to consider improvements. We think it is in their self interest, in terms of the quality of the decisions they make, to consider the diversity of their boards and staff in their own operations.

The only point I make is that I don't think that legislation is needed in that area, but I certainly think that more exhortation on the part of groups like the council—and existence of groups like NCRP—will help deal with that problem.

Chairman RANGEL. You have done it, too, Mr. Joseph, in indicating you don't want any legislation.

Now, it just seems to me that if you have assurances that I cannot get legislation through the House, that perhaps we can come up with some recommendation as to how we can remedy the situation. Basically you are saying is that what all of America is one way or the other supporting, tax exemptions for institutions that are providing a public good, that it appears as though minorities who are paying taxes, too, are not the recipients of this public good, generally speaking.

But if we somehow are able to know who sits on the boards, you are saying, and who is making the decision as to who gets the grants, that it may improve. You don't believe that more legislation, however, would improve the spreading of the grants to include people who look differently or may have different cultural backgrounds from the composition of these boards.

Mr. JOSEPH. Mr. Chairman, I believe, in many areas of public policy, you have competing goods, and I don't share the optimism of some of my colleagues on this panel about the spread and increase of foundations. I happen to think we have a problem.

I would hate to do anything that would discourage creation of foundations. Within the context in which we are operating there is much that we can do to improve the number of minorities and women within the foundation field.

Chairman RANGEL. I am saying, Mr. Joseph, that if everyone could agree that an equitable distribution of the moneys available to include the needy of America could be done—and it is suggested it might be done by improving representation of these people on the boards that are making the decisions—then it seems to me that it may have to be done, if we are going to remove the perception and image of the foundations of being an extension of the "rich white folks" who want to perpetuate their family names.

All of you agree that this is just not so. But if a climate can be created in 1969 when I was not a Member of Congress that merely registering people should be a good reason why foundations should be denied the opportunity to participate in voter education, then I think that my presence in the Congress, certainly on this committee, should try to create an atmosphere which may get them a little upset, that perhaps foundations should be more reflective of what this country is all about, and that their grants should be reflective of the needs of this great country if in fact they are to enjoy different types of tax treatment, which some would consider incentives and others, of course, would consider, call it loopholes, or preferential treatment. In any event, when we establish tax policies, those who work every day and pay their taxes know there are certain people that are not paying at the same rates.

Now, we have to live politically with what decisions are being made by the administration and by the Congress, but some of us also would like to influence the decisions made by those people who exist because of the Congress, and those who have an option that, if they don't like the rules that are set up by the legislature, to do it in a different way for themselves without restrictions and guidelines and without people telling them what to do with, quote, "their money."

Mr. O'CONNELL. May I risk a slight disagreement with you, sir?

Chairman RANGEL. Sure.

Mr. O'CONNELL. Your start from the premise, Mr. Chairman, I believe you said it, that minorities and others do not participate or don't get the benefit of the public good represented by foundations. I would be the first to acknowledge the inequities so I am not taking the opposite side of that.

However, I think if you look at the record of foundations, as I indicated while you were out, not just over 300 years or so but in the last 15 years and what they have represented in terms of change in our society, whether it is their concern about disarmament, concern about day care, concern about women's rights, I dare say that whether it is the support of Johns Hopkins and what it has represented to the health of all the people or what the Ford Foundation meant in terms of bringing people into the mainstream of voting and participation, I dare say that while you cannot identify many grants, certainly not enough, as directed specifically to minority organizations, it is not accurate to suggest that the work of foundations has profited only those who are among the more fortunate in our society.

Chairman RANGEL. I am glad you corrected the perception of my statement if I did say that. I misspoke if I said that. I was only talking in terms of the broad foundation world. As a matter of fact it is my understanding from what Chairman Mills was saying, that the 1969 laws perhaps were changed because the Ford Foundation did attempt to get black folks registered in Cleveland.

So if we have to pinpoint and target foundations that do that, I don't know what the overall information is. You are saying a lot of that information is not available. One thing is clear, that some of the larger foundations are doing great work for Americans, including minorities and highlighting needs of disadvantaged groups. But, they are not the groups you are talking about, because they put out fancy brochures and do let the whole world know that they are proud of what they are doing.

So I had assumed that what we are talking about are those groups that you cannot get their telephone numbers.

Mr. **Joseph**. Mr. Chairman, I might add that I appreciate your concern and it is well taken because I share it. I think that your expressing your concern about this area will be helpful—helpful to the rest of us who share that concern.

Chairman **Rangel**. The record is open for any recommendations, gentlemen, that you want to make.

So that others in the audience don't have fears that this committee has made up its mind as to the direction it is going, I have been mandated by the chairman of the full committee to review the 1969 law to see what impacts it has had, to see whether the rules should be tightened or not.

I hope the Chair would reflect a lot of my personal thoughts, but also if you have any ideas as to how we can be doing a better job, the record will remain open for you to make those contributions, because we have to make recommendations to the full committee, and then they would have to act as a committee as past Ways and Means Committees have operated.

I want to thank you gentlemen for your time.

Mr. **Bothwell**. We have included a complete set of recommendations in our testimony summarized on the last two pages.

Chairman **Rangel**. Thank you very much.

Our last panel today—certainly no one can question the work they have been doing—are the grantees. They are the recipients of the foundations' grants. John Currin, counselor and secretary to the American Red Cross; Marian Wright Edelman, president of the Children's Defense Fund; Father William Cunningham, executive director of Focus: Hope, Detroit, Mich.; Edward Quinn, president, Enterprise Foundation, accompanied by Michael Sanders; Edwin Feulner, president, The Heritage Foundation; and William Barrody, president, American Enterprise Institute.

Mr. Currin, and to all the panelists, your full statements will be entered into the record. You might want to highlight them or make additional statements.

Without objection, they are in the record.

Mr. Currin.

STATEMENT OF JOHN L. CURRIN, COUNSELOR AND SECRETARY, ON BEHALF OF RICHARD F. SCHUBERT, PRESIDENT, AMERICAN RED CROSS

Mr. **Currin**. Mr. Chairman, members of the subcommittee, I am here today on behalf of Richard F. Schubert, president of the American Red Cross. We are pleased to have this opportunity to testify before you as you explore the present status of private foundations and the rules that affect them.

The American Red Cross is a not-for-profit health and human service organization with chapters located in almost 3,000 communities around the country. Created in 1881 by Clara Barton, the organization was chartered by Congress in 1900 and again 1905.

The services it provides include: a nationwide system of disaster preparedness and relief; help to members of the Armed Forces and their families, including emergency communications services worldwide; assistance to veterans, their families and survivors; the collection, processing and distribution of one-half the Nation's supply of blood; health and safety education to individuals in a variety of subjects, from first aid and cardiopulmonary resuscitation to nutrition and control of high blood pressure; youth services designed to enhance leadership abilities and provide young people with opportunities to help others; international services such as assisting Red Cross societies in other countries with disasters and providing other technical aid.

These services of the American Red Cross are made possible by the voluntary contributions of the American people. Responsibility for raising funds rests with the Red Cross chapters, who support their own activities and forward part of what they raise for national activities.

Most of our public financial support for programs other than blood services comes through local federated campaigns, such as the United Way.

But the Red Cross also receives financial support from foundations, directly and through the United Way. Foundation funds have supported ongoing programs, sponsored special projects, provided seed money to start new services, and come to our aid in emergency disaster relief campaigns such as we are conducting right now.

In Mr. Schubert's statement, which I am submitting for the record, is more detail and a few examples of ways all levels of the organization have benefited from foundation support.

In short, Mr. Chairman, private foundations have been a source of steady support for the Red Cross and an ally under circumstances when no other source of funds was available. The long-term value to the Red Cross as the result of their support is incalculable.

If your subcommittee can find ways to increase their abilities to give to the Red Cross, you will have our full support.

That concludes my statement, Mr. Chairman. I am submitting for the record a more detailed statement from Mr. Schubert.

If the subcommittee has any questions, I would be happy to respond.

Chairman RANGEL. Your full statement will appear in the record.

I don't think anybody will have any questions about the fine work that the American Red Cross is doing.

Mr. CURRIN. Thank you, Mr. Chairman.

[The prepared statement of Mr. Schubert follows:]

STATEMENT OF RICHARD F. SCHUBERT, PRESIDENT, AMERICAN RED CROSS

As president of the American Red Cross, I am grateful for this opportunity to present our perspective on the issue of private foundations and the rules that affect them.

The American Red Cross is a not-for-profit health and human service agency. Its services are available through almost 3,000 chapters nationwide, in the nation's possessions and dependencies abroad, and on U.S. military installations around the world. Created in 1881 by Clara Barton, the organization was chartered by Congress in 1900 and again in 1905. But the Red Cross is not a government agency, nor does it receive government appropriations.

Between July 1, 1981, and June 30, 1982, the American Red Cross provided over $583.4 million in services to the American people. These services include:

A nationwide system of disaster preparedness and relief that involves disaster planning, training and emergency assistance to disaster victims. Disaster relief includes dispensing food, clothing, health and medical assistance, temporary shelter, transportation, minor house repairs and other essentials to disaster victims, without charge. Red Cross also works with other voluntary relief groups and with federal and state agencies in the rehabilitation of disaster victims.

Help to individual members of the armed forces and their families, i.e., counseling on personal and family problems, emergency communications services worldwide, financial assistance, social and recreational services to patients in military hospitals.

Assistance to veterans, their families and survivors in processing claims for veterans benefits, and in applying to the Department of Defense to upgrade military discharges. Recreational services for patients in veterans hospitals also are provided.

The collection, processing and distribution of one-half the nation's supply of blood.

Instructional courses for adults and young people in first aid, cardiopulmonary resuscitation (CPR), home nursing, family health, parenting, babysitting, swimming, lifesaving, boating safety and adaptive aquatics for the handicapped, and safety training courses to meet the special needs of industry and government.

Blood pressure screenings and, when necessary, mass immunizations to prevent epidemics. Currently, the organization is expanding its health services as part of a 10-year plan to provide the public with more information and skills on self health care.

Help to elderly persons with special needs, to the chronically ill, the handicapped, the institutionalized, and services for inner-city residents and others with special problems and needs.

Youth services which are designed to enhance leadership abilities and provide young people opportunities to help others.

Providing relief to refugees and victims of disasters abroad; help in reuniting families separated by armed conflict; technical and material assistance to Red Cross societies in other countries; and cooperation with the U.S. government in matters relating to the Geneva Conventions and aid for the victims of critical emergencies that occur abroad.

These services of the American Red Cross are made possible by the voluntary contributions of the American people. Responsibilities for raising funds rests with chapters, who support their own activities and forward a portion of what they raise for national activities. Red Cross Blood Services recover the costs of collecting, processing and distributing blood and blood products by charging fees to the hospitals, clinics, and blood banks who receive the service. There is never a charge for the blood itself, which is donated voluntarily.

Most of our public financial support comes through local federated campaigns, such as the United Way. And here is where the role of private foundations becomes evident: The United Way estimates that 1.8 percent of its support comes from foundations. Almost 93 percent of Red Cross non-blood services funding comes from United Way campaigns. So we can estimate that 1.6 percent of our regular program support comes from private foundations. That translates to almost $3 million in 1982 of program support from foundations.

Beyond ongoing program support, however, supplemental and frequently crucial financial support comes directly to the Red Cross from private foundations. Last year when the terrible flooding and mudslides hit northern California, the Red Cross chapter disaster funds were quickly depleted, but scores of people still needed help. Two local foundations immediately responded with a donation of $100,000.

In 1979, when we conducted our last nationwide disaster fund campaign, foundations contributed approximately $2.5 million of the $12 million raised. The following table compares foundation support to that campaign with other sources of funding:

Corporations	$2,673,573
Foundations	2,670,543
United Way	3,076,480
Chapter reserves	2,509,275
Public contributions	1,497,831
Total	12,427,702

This year, as an unprecedented series of major disasters has again depleted our disaster funds, we will turn again to foundations, and we know they will help. In

Houston, local private foundations have already offered significant and timely support of $275,000.

It was a foundation that sponsored a conference at which Red Cross Health Services took on a whole new direction, toward promotion of good health and prevention of disease and accidents. Another foundation gave $100,000 to help get those new health promotion services off the ground.

Our International responsibilities have been supported by foundations as well. One major east-coast foundation gave $750,000 in 1980 for Red Cross Cambodian relief operations, and another $200,000 for Italian earthquake relief. That same foundation is a regular and loyal supporter of its local chapter, helping to fund a new building and regularly sponsoring new projects.

But it is not always large amounts or dramatic situations that elicit foundation support. Appeals for seed money for a new project, or a special grant for a piece of equipment are frequently made—and answered. For instance, the Piedmont Chapter in Spartanburg, South Carolina, runs a "language bank." It's not a large or expensive operation, but it's a service that the people of Spartanburg would have to do without were it not for the backing of a small local foundation.

In Los Angeles, the Red Cross chapter is currently trying to raise $6 million to pay for a new regional blood center and chapter headquarters. Local family foundations have already donated more than $2 million, and corporate foundations have given almost another $2 million. This kind of backing, we believe, must spring from real and genuine interest in community well-being.

In Tulsa, foundation grants have enabled the chapter to purchase equipment it could otherwise not afford: a specialized microscope that allows the chapter to run tests on people with multiple sclerosis who are in the pheresis program; an automated cell counter, which saves enormous amounts of staff time; and a second pheresis machine that enables the chapter to treat patients as well as accept donors.

In St. Louis, foundation money has paid for a variety of things, from a bookmobile and disaster vans to the equipment and staff time necessary for a two-year effort to train county residents in lifesaving cardiopulmonary resuscitation skills.

Looking to the future, and recognizing the need to free our human resources from paperwork burdens, and to have ready access to essential data, the Red Cross is embarking on a project to bring computerized information systems into use throughout the organization. We have already taken the first step, conducting a careful study to identify what our information needs are. That study was made possible by contributions from the private foundation field. The next step is to determine what kinds of information systems will best handle these needs. Again, we are asking private foundations for help in bearing the costs. When we actually implement the system—and current cost estimates hover in the milions—we will go to foundations all over the country for help.

It is clear that private foundations have been a reliable source of support for the American Red Cross, and an ally when other sources were not available. The long-term value of that support is incalculable. If this subcommittee can find ways to increase the ability of private foundations to give to the American Red Cross, then you certainly have our support.

Chairman RANGEL. Ms. Edelman.

STATEMENT OF MARIAN WRIGHT EDELMAN, PRESIDENT, CHILDREN'S DEFENSE FUND

Ms. EDELMAN. Mr. Chairman, I am glad to be here. We are not quite as safe as the American Red Cross. As advocates, we have been riskier to fund and I don't think the Children's Defense Fund would have existed as it exists today without the help of private funding.

We are a national public charity that tries to provide a leadership voice on issues related to the well-being of children, especially those whose families have few resources to provide for their health, social services, and education. Although we are concerned with all children, we pay particular attention to those who are poor, minority, handicapped, and homeless.

We are here today happily to testify on behalf of the foundations because we, since our inception in 1968 as the Washington research project, have received over $13 million in support from private foundations.

That support has been critical to our ability to provide what we hope is an effective voice to assist children and their parents, develop sound programs, experiment with different approaches to problem solving, and grow in organizational effectiveness.

The first few foundations who funded our project did so because of their deep commitment to equal opportunity in our society, and because they had faith in our ability as people, as professionals, and in our knowledge of the issues that we intended to work on.

We had no institutional record. It was the willingness of a few foundations to invest in new people, in a new project, in new ideas, experiments, and approaches that gave us the room to establish the organization we needed to develop our voice and make a real difference for many children and families.

Foundations are unique in philanthropy for their ability to fund new, risky ideas.

As CDF's reputation has grown and our track record of providing good information and recommending cost effective and sensible services for needy children has been established, we have increased our income from individuals, sales of publications, and other foundations and private sources.

Private foundations will always remain a crucial source of support to CDF. They will enable us to undertake new ventures, and any organization that does not do this, I believe, will not survive.

Private foundation general support also enables us to continue the core of solid research, analysis, and adequate followthrough that is essential to our program goals and effectiveness. It is the long-haul ability to dig into problems and stay with them that has made the crucial difference to our ability to begin to be effective.

For example, in 1981 and 1982, foundation funding enabled us to take a close look at the mental health system for children, issue a book describing the gaps that existed, and plan for and spin off a model direct service program for seriously emotionally disturbed teenagers here in the District of Columbia.

These specific efforts were built on earlier efforts in our core programs, but they were new avenues made possible through private support.

Last year we were able to develop Child Watch, a voluntary citizen involvement project in 37 States with the Association of Junior Leagues and other civic groups. We are currently planning to launch a major new program initiative on black adolescent pregnancy for which we hope to get foundation funding.

As an organization, we hope to never lose our own ability to try new approaches and take risks in helping needy children. General purpose operating support in particular provides the freedom needed to develop and grow as an organization.

Long-term foundation funding has enabled CDF to avoid all Government funds. I am pleased that we have not had to take a dime of Government money.

The independence that private funding has provided has been vitally important to our ability to speak out on behalf of the children and families whose lives are improved by our efforts. For almost 15 years, regardless of the political party in control of the executive branch or of Congress, CDF has been able to speak out for policies that make sense for children whether or not they fit with current political fashions.

For the children who are CDF's clients, this informed and independent voice is vital. Children do not vote or speak out on behalf of their own interests. They are the easiest people in America to ignore. Without the basic private support of groups like ours who speak out for meeting the needs of children, I don't believe they would be met to the same degree today.

What has been crucial, I think, is that we have absolutely no financial stake in the outcome of any issue we advocate on behalf of children and are therefore free to represent children's needs as our research dictates.

This independent voice is also important as it contributes to public understanding of the problems of children. Groups like CDF bring a special knowledge, expertise, experience, and point of view on behalf of their constituents to the free and open exchange of ideas that characterizes the democratic process.

This exchange of ideas and third party voice, recognized as essential by our Founding Fathers, serves to prevent Government inertia, lessens the chance for wrong decisions and unintended results, and contributes to the development of sound, effective, efficient, and responsive Government programs.

Finally, I would say that foundation staff often provides helpful, substantive information, and feedback on the projects we conduct. A number of foundation staff people are experts in their fields. They serve as a clearinghouse for information, help avoid duplication of efforts, and bring together—through working groups, special conferences, and other forums—a variety of people to study problems and develop solutions.

CDF has learned much in the past 15 years. We have made a lot of mistakes. But we think that the foundation investment in us has yielded high returns for children and families of all races and classes.

We also think it has yielded high returns for the Nation in decreased dependency and increased productivity that results from children who stay in school, stay healthy, stay out of trouble, and in families not broken by stress and instability.

Thank you.

Chairman RANGEL. We compliment you, Ms. Edelman, for your continued struggle. We know you are a very effective organization.

[The prepared statement follows:]

STATEMENT OF MARIAN WRIGHT EDELMAN, PRESIDENT, CHILDREN'S DEFENSE FUND

Mr. Chairman and members of the Subcommittee. My name is Marian Wright Edelman and I am the President of the Children's Defense Fund (CDF). I am pleased to have this opportunity to testify on behalf of CDF on the important and unique role that private foundations have played in the work of CDF.

CDF is a national public charity that provides a leadership voice on issues related to the well-being of children, especially those who have the least family resources to provide for their health, child care, social services, and education. Although we are concerned with all children, we pay particular attention to poor, minority, handicapped, and homeless children.

Through a variety of strategies, including public education, providing information and assistance to parents, concerned citizens, and organizations working on behalf of children, and research, CDF seeks to meet the basic survival needs of children and to encourage preventive investment in the future by providing for children before they get sick, drop out of school, get into trouble, or suffer family breakup.

Our five program areas are education; child health and mental health; child welfare; child care; and family support services. Our staff of 60 includes: program and public education specialists; researchers; lawyers; and writers. In addition to our main office in Washington, D.C., we have two state offices in Columbus, Ohio and Jackson, Mississippi, a staff representative in Rochester, New York, and affiliated Child Watch projects in over 100 communities in 37 states and the District of Columbia.

CDF's activities are supported primarily by foundation and corporate grants, donations from thousands of individuals and organizations, and sales of publications. Nearly 80 percent of our budget last year was funded by foundations. We have never accepted government grants or contracts.

We are here today to testify because CDF, since its inception in 1968 as the Washington Research Project, has received over $13 million in support from private foundations. That support has been critical to our ability to assist children and their parents, develop sound programs, experiment with different approaches to problem solving, and grow in organizational effectiveness.

The first few foundations who funded our project did so because of their deep commitment to equal opportunity in our society, and because they had faith in our ability as people, as professionals, and in our knowledge of the issues that we intended to work on. We had no institutional record. It was the willingness of a few foundations to invest in new people, in a new project, in new ideas, experiments, and approaches that gave us the room to establish the organization we needed to develop our voice and make a real difference for many children and families. Foundations are unique in philanthropy for their ability to fund new, risky ideas.

As CDF's reputation has grown and our track record of providing good information and recommending cost-effective and sensible services for needy children has been established, we have increased our income from individuals, sales of publications, and other foundations and private sources. Private foundations will always remain a crucial source of support to CDF. They will enable us to undertake new ventures. Private foundation general support also enables us to continue the core of solid research, analysis, and adequate follow-through that is essential to our program goals and effectiveness. For example, in 1981 and 1982, foundation funding enabled us to take a close look at the mental health system for children, issue a book describing the gaps that existed, and plan for a spin off a model direct service program for seriously emotionally disturbed teenagers here in the District of Columbia. While these efforts built upon the earlier efforts of our core child welfare program, they were new avenues made possible by private foundation support. Last year, private foundation general support enabled us to develop Child Watch: Looking Out for America's Children, a volunteer citizen involvement project in 37 states developed with the Association of Junior Leagues and other civic, religious, and women's groups. We are currently launching a major new program initiative on black adolescent pregnancy, for which we hope to get foundation funding. As an organization we hope to never lose our own ability to try new approaches and take risks in helping needy children. General purpose operating support in particular provides the freedom needed to develop and grow as an organization.

Long-term foundation funding has enabled CDF to avoid all government funds. The independence that private funding has providing has been vitally important to our ability to speak out on behalf of the children and families whose lives are improved by our efforts. For almost 15 years, regardless of the political party in control of the Executive branch or of Congress, CDF has been able to speak out for policies that make sense for children whether or not they fit with current political fashions.

For the children who are CDF's clients, this informed and independent voice is vital. Children do not vote or speakout on behalf of their own interests. They are the easiest people in America to ignore. They depend on adults to speak for them. Their parents often lack the confidence, information, access, and resources to question or affect policies of vital importance to their children's lives and future. Without CDF's voice, and without the support of private foundations to continue that voice, many of the basic nutritional, health, and educational needs of the most vulnerable children would not be met to even the degree they are today. CDF has no financial stake in the outcome of any issue, and we are free to represent children's needs as our research and expenditures dictate.

This independent voice is also important as it contributes to public understanding of the problems of children. Groups like CDF bring a special knowledge, expertise, experience, and point of view on behalf of their constituents to the free and open exchange of ideas that characterizes the democratic process. This exchange of ideas and third party voice, recognized as essential by our founding fathers, serves to prevent government inertia, lessens the chance for wrong decisions and unintended results, and contributes to the development of sound, effective, efficient, and responsive government programs.

Finally, foundation staff often provide helpful substantive information and feedback on the projects we conduct. A number of foundation staff people are experts in their fields. They serve as a clearinghouse for information, help avoid duplication in efforts, and bring together—through working groups, special conferences, and other forums—a variety of people to study problems and develop solutions.

CDF has learned much in the past 15 years. We have made some mistakes. But we think that the foundation investment in us has yielded high returns for children and families of all races and classes. It has also yielded high returns for the nation in decreased dependency and increased productivity that results from children who stay in school, healthy, out of trouble, and in families not broken by stress and instability.

I would like now to tell you something about the Children's Defense Fund—the children for whom we work, some of our specific activities on their behalf, and our track record over a decade of improving the lives of millions of American children. I hope that this will give you a sense of what activities are carried on by such a group and the importance of foundation funding to millions of our country's most vulnerable children.

AMERICA'S CHILDREN

Children are over one-fourth of the population of this country. Many, through no fault of their own, are handicapped by economic physical, social, or environmental circumstances.

CDF has carefully examined many of the major problems facing children, and before launching a program effort, has researched, analyzed and documented what we have found. We always try to be constructive by laying out specific suggestions as to what can be done, and sharing models of programs that can be duplicated. Some of the major problems for chldren today are:

Children are disproportionately poor

Children are more likely to be poor than any other group in America. In 1981, 12.3 million of them, or 1 in 5, lived in poverty.

In the past two years, more than 2.5 million children have fallen into poverty. The poverty rate is now as high as it was in 1965, before the War on Poverty began.

Black children are more than three times as likely as white children to be poor. A Black baby born today has nearly a one in two chance of being born poor and faces a losing struggle to escape poverty throughout childhood.

Children have serious health problems

Nine million American children (1 in 7) have no known source of regular health care and 18 million (1 in 3) have never seen a dentist.

Half our preschool children are not immunized against mumps; 40 percent are not immunized against polio; 35 percent are not immunized against rubella (German measles); and 30 percent are not immunized against diphtheria-pertussis-tetanus (DPT). The proportion of preschool children immunized against polio and against DPT has declined since 1965.

A black baby is three times as likely as a white baby to have a mother who dies in childbirth.

Children are excluded from school

Over 300,000 children who are required by law to attend school do not.

Many other children are enrolled in school, but do not receive the instruction they need to succeed. About 450,000 children with limited or no English speaking ability do not receive appropriate bilingual instruction.

Over 300,000 handicapped children do not receive special education services.

Some 13 percent of all 17-year-olds are functionally illiterate.

Children are homeless

500,000 children in any given year are homeless, in costly foster care or institutional care, denied the nurturance and family stability every child deserves.

Children are left alone or in inadequate child care

There are an estimated six to seven million latchkey children in this country who are left to care for themselves while their parents work. Many of these children are as young as six years old.

CDF'S PROGRAM FOR CHILDREN

CDF's emphasis is primarily on institutional rather than individual abuse and neglect; on preventive rather than more costly remedial measures; and on defining and enforcing appropriate policy interventions to benefit children and their families. To some extent we act to assure that others provide direct services. This is one of the direct services that we provide.

In each of our major program areas—education, child health and mental health, child welfare, and child care and family suppot services—CDF strives to ensure:

Access.—To existing programs and services for children most in need and creation of new services and programs where necessary.

Fairness.—Enforcement of civil rights laws designed to ensure equal treatment for female, handicapped, nonwhite, and non-English speaking children.

Implementation.—Assurance that all laws intended to benefit children and their families do so and do so efficiently.

Accountability.—Information for parents about children's needs, programs, and rights so that parents can be more aware of policies that affect their children and help ensure proper implementation of policies, programs, and services on their children's behalf.

Parent and community role.—Strengthening the capacity of parents, citizens, and communities to stand up for children and play a significant role in making decisions that affect their children's lives, and ensuring that federal and state laws as well as private sector policies and practices bolster, rather than undermine, family stability.

Resources.—Assurance that children's programs are not always the first and deepest cut and that adequate resources are provided for programs essential to the survival and growth of millions of our children.

CDF'S TRACK RECORD FOR CHILDREN

As a result of CDF's activities and work with individuals and organizations around the country, hundreds of thousands of handicapped, poor, and minority children previously excluded from school are now receiving an education; millions of children are now entitled to dental and improved preventive health services; hundreds of thousands of Head Start children continue to get comprehensive child development services which have proven their long-term success by preventing the need for costly remedial programs in later years; and major child welfare reforms have been adopted that hold out hope for family permanence for the nearly 500,000 children in America growing up without homes.

Our 34 books and handbooks have generated much media and policymaker attention to children's needs. A number have prompted or contributed to significant public changes. Each book has documented a major problem area affecting large numbers of children, recommended appropriate governmental and private sector policy responses at the local, state, and national levels, and described positive responses or models to the problems described where possible.

EDUCATION

Our main goal in education is to get and keep children in school. CDF's first book, Children Out of School in America (1974), brought to the public attention that two million school-aged children were not enrolled in any school. This was an issue of great concern to parents around the country. The project methodology, which included heavy involvement of local citizens, has been used again in our other publications.

To research Children Out of School, we knocked on more than 8,500 doors in 30 areas in nine states—Alabama, Colorado, Georgia, Iowa, Kentucky, Maine, Massachusetts, Mississippi, and South Carolina—and in the District of Columbia. We talked to over 6,500 families.

The book generated over 300 articles, editorials, and professional reviews. CDF staff has since worked with national, state, and local officials and community groups to reduce through a variety of strategies the non-enrolled school population by half.

A subsequent report, School Suspensions: Are They Helping Children? (1975), documented the widespread use of school suspensions for such problems as truancy, tardiness, and dress code violations and their disproportionate impact on minority children. It offered constructive in-school disciplinary alternatives to school officials for meeting those problems.

Since publication of these two books, many state and local officials have studied more closely why children in their area are out of school and, in many cases, exclusionary policies have been changed. Programs to help children in school have been implemented in school districts around the country.

CDF has worked with a coalition of groups in California, Colorado, Illinois, New York, Tennessee, Vermont, Florida, Mississippi, Texas, and Pennsylvania to monitor implementation of the Education for All Handicapped Children Act—Public Law 94-142. We also published a booklet for parents, 94-142 and 504: Numbers That Add Up to Educational Rights for Handicapped Children (1978), which has been distributed for free or sold inexpensively to over 30,000 parents and professionals.

After four years of community education and litigation by parents represented by CDF attorneys, state and local officials in Mississippi entered into an agreement that ensures that 40,000 Mississippi children classified as handicapped receive appropriate education programs and special services. Many had previously been excluded from school.

We have distributed 15,000 copies of a CDF publication, Your School Records (1976). This booklet was part of a successful effort by CDF staff to ensure access by parents to children's school records and the confidentiality of such records against third party use without parental consent or notification. The booklet provides parents with an easily understood explanation of their rights to privacy for school records.

CDF has also played a major role in the upgrading of educational and welfare services of the two major child serving institutions in Mississippi, the Oakley Training School and the Central Mississippi Retardation Center.

CHILD HEALTH AND MENTAL HEALTH

The goal of CDF's child health program is to ensure access to primary and preventive health care for the 9 million American children who have no known source of health care and the 18 million children who have never seen a dentist. To accomplish this goal, CDF has focused attention primarily on improving and expanding EPSDT (Early and Periodic Screening, Diagnosis and Treatment), the Medicaid program for children.

In two child health books, "Doctors and Dollars Are Not Enough" (1976) and "EPSDT: Does it Spell Health Care for Poor Children?" (1977), CDF highlighted the plight of children without health care. The books aided policymakers by supplying a careful study of the law's intended benefit and a detailed analysis of the actual practices in many states. The books have led to significantly added resources in child health services as well as improved administration by the Department of Health and Human Services of the EPSDT program.

In January, CDF released a 50-state survey of Medicaid, Title V Maternal and Child Health, and Community Health Centers services for poor mothers and children which revealed that many thousands currently face health emergencies and are being denied services vital to life and health. We think this—the only survey of actual impact of federal health policies in communities—will help many policymakers hold the line on vital maternal and child health services.

CDF also recently published a study of state and national mental health services, Unclaimed Children: The Failure of Public Responsibility to Children and Adolescents in Need of Mental Health Services. It has been sent to all the nation's governors and to key mental health professionals, and CDF staff is following up with appropriate contacts.

CDF has worked with organizations around the country and Federal agency staff to ensure the continuation of funding for rural health clinics for children. Success has resulted in the continuation of these clinics and the delivery of health services to children badly in need of primary health care.

Currently, CDF is providing direct services—training, research, and technical assistance—to community groups in Tennessee, Georgia, and Alabama to assist them in ensuring that children in their states receive the EPSDT health services to which they are entitled.

CHILD WELFARE

CDF's program in the child welfare area is directed toward giving thousands of children without homes a chance for family permanence and, for thousands more, a chance that services will prevent their unnecessary removal from home in the future.

The analytic framework set out in CDF's publication, Children Without Homes (1979), has been used by a number of states to examine and change their child welfare policies and treatment of children who are in institutions, group homes, and foster care. More than 12 states have adopted external foster care review systems in the last three years and a number of additional states have passed reforms in the area of preventive services and termination of parental rights.

A CDF lawsuit, *Gary W.* v. *State of Louisiana,* succeeded in returning over 600 Louisiana children to their home state from Texas institutions where many of them had been inappropriately placed and even abused. The court's decision established the important principle that when handicapped or neglected children are removed from their homes and placed in state care or custody, they have the right to individual assessment and placement in the least restrictive setting appropriate to their needs. We have worked closely with Tulane University and child welfare officials for three years after the decree to ensure proper implementation.

In the District of Columbia about 500 handicapped children who have been placed, or been at risk of placement, in costly acute care hospitals and inappropriate mental and other institutions, now have a chance for placement in more humane and cost effective community-based settings. A CDF lawsuit brought on their behalf ended in a consent decree with the District Government. CDF also took the further step of developing City Lights, a community-based model foir deinstitutionalizing seriously emotionally disturbed adolescents. City Lights has, after 18 months, become independent of CDF and is now operating under the direction of a prestigious community board. A direct care day and residential program providing a structured therapeutic environment for presently institutionalized adolescents, it has received strong support from local government and school officials.

CHILD CARE AND FAMILY SUPPORT SERVICES

CDF has worked to expand and improve child care options available to children and parents.

Two 1982 CDF publications, The Child Care Handbook and Employed Parents and Their Children, present the latest data on the need for child care and the variety of ways communities are responding.

In the last five years, working with the National Head Start Association and its affiliates throughout the United States, CDF has played a key role in increasing public and policymaker awareness of the quality and cost effectiveness of Head Start's services. Since 1965, Head Start has provided services to 7.8 million children and their families. Studies have shown that Head Start improves children's health; helps children stay at grade level and out of costly special education; involves parents in their children's education and development; and develops the self-sufficiency of parents. Head Start's appropriations have more than doubled in the last five years, and CDF's budget work was an important factor in helping achieve this result.

CDF was instrumental in recently convincing the Internal Revenue Service to allow families who are eligible for a recently enacted child care tax credit to use the short form and claim the credit. This change, eventually supported by the White House, can benefit up to 6 million families.

CHILD WATCH: LOOKING OUT FOR AMERICA'S CHILDREN

In January 1982, CDF initiated Child Watch in collaboration with the Association of Junior League (AJL), in international women's volunteer organization with 238 chapters and approximately 135,000 members, and nine other voluntary organizations. The goal of Child Watch is to increase public awareness of the needs of children and their families in the areas of foster care and adoption, child care, child health, and public assistance. Volunteers interview officials, child workers, advocates, and parents in their area to find out what is happening for children.

Over 800 volunteers have been recruited and trained by CDF in collaboration with the AJL, Church Women United, National Council of Negro Women, Lutheran Church in America, Council of Jewish Federations, National Association for the Education of Young Children, United Methodist Women, YWCA, League of United Latin American Citizens, and the Southern Rural Women's Network.

During 1982, volunteers conducted over 100 Child Watch projects in 39 states and the District of Columbia, including five statewide projects. Altogether, they completed over 1,600 interviews, and more than thirty projects will be conducting a second round early this year.

These are some of the many activities that CDF has engaged in, and continues to conduct, for the most vulnerable children in society. We think that children, their families, and our nation are all served by the investment private foundations have made, and continue to make, in this work and in the work of groups like CDF.

Chairman RANGEL. Father Cunningham.

STATEMENT OF REV. WILLIAM T. CUNNINGHAM, EXECUTIVE DIRECTOR, FOCUS:HOPE, DETROIT, MICH.

Reverend CUNNINGHAM. Congressman Rangel, it is a pleasure to have met you.

Focus:HOPE rose from the ashes of riot and rebellion and racial violence smoldering in the city of Detroit after the summer of 1967. Focus:HOPE is a civil and human rights organization of 23,000 volunteers and 200 employees working in Metropolitan Detroit to root out racism and remedy the effects of discrimination. Our goal is racial justice and integration.

Focus:HOPE projects characteristically aim at enablement: the enablement of poverty-level infants and preschool children to become alert learners and productive adults by providing food for adequate nutrition; the enablement of the elderly to maintain their independence through sufficient food and community caring; the enablement of minority employees to reach whatever level of income or position their merit allows; the enablement of black and white youngsters in desegregated high schools to appreciate the rich benefits of integration; the enablement of unemployed minorities to begin careers in skilled machinist trades in the mainstream of our economy.

In July upcoming, the Ford Motor Co. Fund will do something government is unable to do in these times of budgetary constraint. Their gift will enable Focus:HOPE to bring U.S. Department of Agriculture officials and congressional aides to Detroit to view firsthand the Nation's largest commodity supplemental feeding program.

Focus:HOPE last month provided a complete month's supply of food for 53,418 mothers, infants, and preschoolers, assuring the necessary nutrition for normal birth and growth.

These officials and aides will see USDA commodities being stored and distributed from a building donated to Focus:HOPE by the Louise Tuller Miller Trust and the National Bank of Detroit. They will see nutrition education being delivered via large screen monitors at the food centers, using videotapes produced by Focus:HOPE with equipment donated by the Detroit Free Press charities and the Ford Foundation.

They will see a computer recordkeeping system for food inventory and registration of needy families donated by shared grants from the Kresge Foundation, the McGregor Fund, and others.

Then several hundred feet from one of our food centers, our guests will visit Focus:HOPE Industry Mall and Machinist Training Institute, a true public-private partnership. In its origins, this project was entirely the product of collaborative efforts among private foundations and corporations.

With a generous grant from the Ex-Cell-O Foundation, Focus:HOPE was able to purchase an 11½-acre industrial complex at the core of Detroit's jobless community. The alternative was to steelball all the buildings.

In little more than 2 years, with sustaining support from the Mott and Webber Foundations, the McGregor Fund, General Motors, Ford Motor Co., Bendix, Burroughs, Detroit Edison, Michigan Bell, and others, this site has become the largest center in the country for high skill training, new employment, and the development of minority ownership in machine tool production.

In a visit to Industry Mall last October, Vice President George Bush announced Federal support for the project, calling it "a model, a shining example for the creation of similar programs throughout the United States."

Crossing the street, our important visitors will enter the Focus:HOPE Resource Center, donated in 1975 by the Kresge Foundation. Here they will see volunteers working on the waiting lists of over 9,000 elderly for our Food for Seniors Pilot. The pilot tests the distribution of a commodity food supplement to the elderly poor as a way of reducing health care costs.

To bring this program for judgment before Congress in 1984, Focus:HOPE will require substantial support from private foundations to assure complete evaluation and dissemination of its methods and results. Moneys to do this have twice been denied by the Administration on Aging.

Our guests will also see the wind down—and this is critical in light of some of the things said earlier—will see the wind-down of a 12-year Federal litigation fought in the eastern district court with the Automobile Club of Michigan. This case, establishing a landmark ruling on the device of moving away to avoid hiring blacks, won the most significant affirmative action goals to date for any corporation in the United States.

Moneys to help support this legal battle were not, Mr. Rangel, as you might guess, readily available through foundations, although the Campaign for Human Development, the Class Action Fund, and the Ratner Foundation made critical contributions.

Focus:HOPE views the goals and objectives of philanthropic giving as a barometer for the conscience and social enlightenment of our Nation.

Philanthropy is an expression of the best ideals that a person can envision. It represents the realization of dreams to create what our people do not have on the part of those who have been our Nation's most successful and rewarded citizens.

Philanthropic generosity and ideals must be as uninhibited and as free as possible. Tolerance must be extended for the mischievous or self-serving, so that our most treasured path to progress remains open. For at its best, private giving is the vanguard of social change, cultural development, and justice.

Focus:HOPE is deeply indebted to the foundations and trusts which have exercised their stewardship in the support of our goals for human development and racial justice.

Thank you, Congressman.

Chairman Rangel. Thank you for the work of Focus:HOPE. It is certainly well known by the Members who come from that part of the country.

The Enterprise Foundation, Mr. Quinn, president.

STATEMENT OF EDWARD L. QUINN, PRESIDENT, ENTERPRISE FOUNDATION, ACCOMPANIED BY MICHAEL SANDERS, COUNSEL

Mr. QUINN. Mr. Chairman, and Mr. Pickle, thank you for the opportunity to be with you this afternoon. I have with me Mike Sanders, counsel for the Enterprise Foundation.

I submitted my formal statement and would like to have that entered in the record.

[The prepared statement follows:]

STATEMENT OF EDWARD L. QUINN, PRESIDENT, THE ENTERPRISE FOUNDATION

My name is Edward L. Quinn. I am President of The Enterprise Foundation of Columbia, Maryland, a newly created charitable organization formed to provide affordable housing for the very poor and to use housing as an organizing tool to begin meeting other human needs.

I welcome this opportunity to speak with you today to present a brief history of The Enterprise Foundation and to describe its unique commitment to improving the lives of the very poor by channeling private sector funds into community-based nonprofit enterprises through creative financing and grant techniques. Enterprise was formed at a time when government spending for programs that benefit the very poor was dramatically reduced. The overwhelming response by the private sector, and in substantial part by private foundations, has enabled the Foundation to make significant progress toward achieving its goals in the brief two-year period of its existence.

We understand the increasing demands on private foundations to meet certain basic human needs that the government cannot, and we commend private foundations for their willingness to be involved in efforts to address these new problems. While we agree with the underlying purposes of the private foundation legislation enacted in 1969, we also support efforts by Members of Congress to ease certain impediments to effective private philanthrophy, such as those proposed by Congressman Conable in H.R. 3043, and thereby to stimulate the creation of new foundations as well as the growth of those now in existence.

I. WHAT IS THE ENTERPRISE FOUNDATION

The Enterprise Foundation evolved from a vision of its founder, James W. Rouse, who, after years of successful experience as a mortgage banker and real estate developer, decided to direct all his resources and expertise into improving the conditions of the very poor. To accomplish his goals, Mr. Rouse created The Enterprise Foundation in 1981. He serves as its Chairman of the Board as well as Chief Executive Officer and one of its Trustees. He brings to his work more than forty years experience in the housing industry, as well as an active involvement in urban renewal programs dating back to 1954.

He is perhaps best known for the projects of The Rouse Co., which pioneered a new concept in downtown development in such projects as Fanueil Hall in Boston, Harborplace in Baltimore, the Gallery at Market East in Philadelphia and Santa Monica Place in Santa Monica. Each of these projects brought new life and blighted downtown areas. The Rouse Co. also planned and developed Columbia, Maryland which is heralded as the best of the new towns. Mr. Rouse has now retired as Chief Executive Officer of The Rouse Co. He continues as Chairman of the Board. He devotes full time to the work of the Enterprise Foundation and its wholly owned subsidiary, The Enterprise Development Co.

Mr. Rouse was able to attract a prestigious and talented Board of 22 individuals who share his vision and concern for the poor. Represented on the Board is a Senator, a former Congressman, a former secretary of HUD and HEW, a former President of the World Bank, a clergyman, businessmen and others. (A complete list of Board members is attached.)

The Trustees' fund-raising efforts have been very successful. They set an initial five year fund-raising goal of $15 million. Through the generosity of foundations, corporations, and individuals, the Foundation raised close to $13 million its first year. In response to that enthusiastic response from the private sector, the Foundation increased its five year goal to $25 million.

Numerous private foundations, as well as corporations and individuals made financial commitments to the Foundation last year. The Foundations included Alcoa Foundation, Atlantic Richfield Foundation, The Joyce Foundation, The Ford Foundation, Ernest W. and Jean E. Hahn Foundation, John D. and Catherine T. MacArthur Foundation, The Andrew W. Mellon Foundation, Richard King Mellon Foundation, Charles Stewart Mott Foundation, The Piton Foundation, the Rockefeller Brothers Fund, and Miriam and Ira D. Wallach Foundation. The Enterprise Foundation continues to seek support from foundations and others in the private sector so that the work of the Foundation may continue to prosper and expand.

II. THE ENTERPRISE PROCESS

The Foundation's primary objective is to work with neighborhood groups to provide affordable housing for the very poor and to use housing as an organizing tool to meet other basic human needs and help lift the poor out of the cycle of poverty and dependence into the mainstream of American life. Enterprise promotes these objectives by providing funds, technical assistance and other general support to organizations that pursue this "holistic" approach to community development. It seeks to "leverage" its contribution by stimulating new forms of cooperation between the voluntary sector and the business and commercial communities. It has thereby been instrumental in generating creative combinations of low-interest vehicles, guarantees, mortgage subsidies, and other forms of financing. Enterprise is building a network of housing groups across the country so that it may transfer successful experiences—and failures—from one group to another. In addition, it is developing a staff with specific skills in housing finance and low cost rehabilitation so that it can help groups develop housing projects that are affordable to the very poor.

The Foundation began operations with the belief that there are many neighborhood groups working with deep commitment and determination to improve the housing and lives of the poor, but that they were limited by lack of funds and in the knowledge and skills required to be most effective. Field experience convinced the Foundation that there are thousands of caring, competent, committed people at work in diverse ways to improve the housing and lives of the very poor. However, these neighborhood groups need help in improving rehabilitation techniques to reduce costs, in developing new systems of financing housing rehabilitation, and in finding new ways to improve systems for delivering human services to the poor in order to make a difference in individual lives.

The Enterprise Staff evaluates a potential group on the basis of its effectiveness in meeting certain basic criteria, including:

Working with the very poor to rehabilitate housing;

Using volunteers—tenants, community residents and others;

Enlisting business and professional volunteer services;

Assisting residents in managing properties; and

Developing programs to meet other human needs such as job training and placement, health services, education, child care and recreation.

Jubilee Housing, Inc. of Washington, D.C. has served as the model from which these criteria were drawn. That program has been an inspiration to countless groups across the country because of its innovative approach to dealing with the needs of low income residents' in the Adams Morgan neighborhood.

Jubilee Housing began in 1973 with the efforts of three people who wanted to do something about the deplorable housing conditions in Adams Morgan. They found two old buildings with 90 apartments, and began the rehabilitation process. Today, Jubilee Housing owns 213 apartments in six buildings in the Adams Morgan community. Residents are actively involved in the management and maintenance of their buildings through volunteer committees that engage in activities ranging from cleaning to rent collection.

The essence of the Jubilee approach to housing can be seen from the broad range of programs and services provided the residents extending far beyond affordable and safe housing, including Jubilee Jobs, an employment center, Columbia Road Health Center, a non-profit health care agency, and Family Place, an organization which offers support and counseling for expectant mothers and parents of young children.

To date, the Enterprise Foundation has provided grants and loans of $282,500 to support the work of Jubilee Housing, Inc. These funds are used for acquisition and rehabilitation of additional housing units, an innovative anti-drug and crime prevention program, and staff and administrative costs associated with handling the numerous visitors Enterprise sends to Jubilee. It has committed additional financial assistance of $650,000.

Once a decision is made to bring a group into the Enterprise Network, the full resources of the Network are employed to provide on-going financial and hands-on field support to help the group realize its goals. The approach is flexible. A Foundation field officer works closely with the group to determine the critical areas where our help is needed. In addition to grants, loans, and field assistance for projects, the Foundation helps a group develop contacts with the business community to build support.

During 1982, the first full year of operation, successful supporting relationships were established with non-profit neighborhood housing groups in six cities. The Foundation made 12 commitments for grants or loans totaling $283,250 to these groups during that time. In the first six months of 1983, housing groups in 4 new cities were added to the Network, with grants or loans totaling $2,309,875 to all of these groups. The plan is to add 2 more cities in 1983, and 50 cities within 5 years.

A sampling of Enterprise support to Network groups in 1982-83 illustrates the diverse ways Foundation funds are used to benefit the poor:

The New Orlando.—In 1982, Enterprise assisted Hope Communities in Denver in developing a financing package that would make it possible to restore a gutted building in the neighborhood to productive use as 20 units of low income housing without the benefit of a deep federal government subsidy. The project's financing combines a low interest loan from Enterprise (which funds were provided by the Ford Foundation as a program related investment), grants from Enterprise and other private foundations, a grant from the State of Colorado, a low interest loan from the City of Denver, and equity financing through a syndication of "benevolent" investors. (The "benevolent" investors in the New Orlando were willing to accept a lower return and higher risks than would be involved in the customary tax shelter.)

The Lynchburg Covenant fellowship home ownership programs.—Enterprise worked closely with the Lynchburg Covenant Fellowship group in Lynchburg, Virginai, to develop a home ownership program affordable for low income families. Under this program, 20 new homes will be constructed and sold to low income buyers at a price of $26,000 each. The houses will be affordable to families earning $9,000-15,000, because of an innovative financing structure that brings in a local bank with the inducement of an Enterprise loan guarantee and mortgage subsidy for the families. Enterprise also provided a grant to cover administrative costs associated with selecting families and training them to assume ownership responsibilities.

Jubilee West, fundraising support.—Jubilee West of Oakland, California, was a relatively new organization when it joined the Enterprise Network in 1982. To assist Sister Joanna Bramble and Sister Pat Sears in generating local support for its programs among the business community, Jim Rouse visited Oakland and spoke to the Bay Area Council, the Oakland Chamber of Commerce, and a gathering of 200 people at the neighborhood's St. Patrick's Center. In addition, letters of support were sent to Oakland foundations and corporations to encourage funding support. (The 1982 Jubilee West Fund Raising Campaign yielded over $200,000 in grants and loans that will be used to finance low cost housing and other support services for the poor.)

Jubilee West, grant and technical assistance.—Enterprise recently provided funds to Jubilee West to acquire and renovate 20 units of housing to take advantage of the few remaining rent subsidy contracts available under HUD's Section 8 housing program. Enterprise approved a challenge grant of $55,000, toward a total project cost of $660,000, to be raised from private sources. In order to make the project affordable to the community, Enterprise sent a consultant to Oakland with advice on reduction of project costs.

Cleveland housing network, cash flow line of credit.—The Cleveland Housing Network, a consortium of non-profit groups, is developing low cost housing in six different Cleveland neighborhoods. The Network's programs are funded by a variety of local and national foundations and corporations, all of which operate on different funding cycles. Therefore, Enterprise is providing the Network with a $100,000 Line of Credit that can be used to meet temporary cash requirements when funds have been committed from another source but not yet disbursed. This Line of Credit will prevent unnecessary delays to rehabilitation crews.

III. FUTURE FUNDING

The Enterprise Development Co. ("EDC"), a wholly-owned for profit subsidiary of Enterprise Foundation, will provide a future source of funding for the Foundation. EDC is developing Rouse-style festival marketplaces patterned on Harborplace in Baltimore, in smaller cities across the country. Its first project, the Waterside in Norfolk, Virginia, opened this summer. Projected cash flows in the years to come will be used to support the low-income programs of the Foundation. In addition to providing funds for the Foundation's activities, the Waterside has brought jobs, new minority businesses and a new spirit and pride in the community. It is estimated that the merchants in Waterside now employ approximately 1300 people. Of these, 775 were previously unemployed, 470 are blacks and 160 live in public housing. Waterside Associates, which operates the project for Enterprise, employs 56 full time people in the maintenance, housekeeping and security departments. Nearly all of these employees were previously unemployed black youths were recruited, tested and trained by Southeastern Tidewater Opportunity Industrialization Center (STOIC), a group that works with the chronically unemployed.

IV. CONCLUSION

With the generous and enthusiastic support of broad segments of the private sector, principally private foundations, the Enterprise Foundation has successfully initiated programs to assist the very poor in obtaining housing and meeting other basic human needs. Over 60 percent of Enterprise's support has come from private foundations, which as a group have been particularly receptive to Enterprise's programs.

If government cutbacks in social welfare programs continue as predicted, Enterprise and other charitable organizations created to help those most affected by such cutbacks will inevitably face increased demands for expansion of their programs. They will, in turn, look to the private sector for additional funds to meet new and greater needs. Private foundations, whose assets are permanently dedicated to charitable purposes, represent the largest source of potential funding for Enterprise and other charitable organizations, and should be commended for their response to increased demands on their resources in recent years. To encourage and facilitate further private foundation giving, we support legislation such as H.R. 3043, introduced by Congressman Conable and others to remove certain impediments to effective private foundation philanthrophy without weakening the underlying purposes of the 1969 private foundation legislation.

The bill meets head-on the problems of declining formation of new foundations and injection of badly needed funds into already existing foundations. H.R. 3043 would thus prevent any threat to the continuing energy created by this sector of private philanthrophy. H.R. 3043 also contains vital provisions to simplify the 1969 legislation, reducing costly administrative burdens on foundations, and allowing these same foundations to utilize their unique capabilities in more effectively supporting charitable causes.

[From Business Week, Mar. 28, 1983]

[Attachment 1]

JIM ROUSE'S REVOLUTION IN HOUSING FOR THE POOR

A MAVERICK URBAN DEVELOPER APPLIES HIS SKILLS TO RESCUE RUNDOWN RESIDENTIAL AREAS

When Rosa Hatfield, a welfare mother of four, heard that the Ritz was being sold, four years ago, she was filled with trepidation. The dilapidated tenement in the Adams-Morgan section of Washington had been her home since she escaped a sharecropper's life in North Carolina. Recalls Hatfield: "I came to Washington with all the hatred for the whites. And all I could think of was, 'What are they going to do to us now?' "

Today, Hatfield lives in the suburbs. She manages a renovated Ritz and our other former tenements, which are now owned by Jubilee Housing Inc., a church-affiliated, not-for-profit organization. Jubilee volunteers operate a clinic and job-placement service, provide drug-abuse counseling, and help tenants run their buildings. Periodically, Hatfield helps Jubilee and its benefactor, James W. Rouse, by taking the Adams-Morgan success story on the road to corporate executives and winning their financial support.

The real estate shaman who founded Rouse Co.—now with $898 million in assets—is best-known for his two maverick alternatives to urban development: "festival marketplaces" such as Harborplace, which helped rejuvenate blighted Baltimore, and Columbia, Md., heralded as the best of planned communities.

Into the mainstream

Now that he has retired from his company, 68-year-old Rouse is applying his retailing and housing knowhow to benefit the very poor—families with annual incomes of less than $9,000. Two years ago. Rouse created the not-for-profit Enterprise Foundation, which grew out of, and will try to replicate, the Jubilee model nationwide. Enterprise will help communities acquire and renovate tenements without displacing residents. Rouse calls this "the most important thing I've ever done . . . lifting the poor out of [their] cycle of dependence into the mainstream of life."

To make Enterprise prosper, Rouse must not only carefully select groups that can shape a socially responsive citizenry; he must also actively solicit financing. At a time when federal funding for urban projects is scarce, Rouse is mounting an audacious private-sector urban renewal campaign. Trading on his famed powers of persuasion and negotiating skills, he is raising money by assembling a grab bag of government grants, private contributions, tax-shelter syndications, and below-market-rate loans.

Long-term funding will come from Enterprise Development Co., a taxable, profit-motivated real estate subsidiary of Enterprise that will develop Rouse-style festival marketplaces in small cities. Its first, the Norfolk (Va.) waterfront renovation, will be completed this summer.

Enterprise will be financing community groups in eight cities by the end of March. And within a decade, Rouse anticipates, Enterprise will have sites in 50 cities. Other groups are standing in line to be Enterprise affiliates, much as cities have been clamoring to become sites for Rouse festival marketplaces.

Ironically, almost everyone scoffed when Rouse created Faneuil Hall Marketplace in Boston, his first Disney-like retail center. (Rouse mischievously calls Disneyland "the best piece of urban design in America.") During the late 1970s, when suburban malls—including his own—were still flourishing, he saw tremendous potential for creating a unique retailing concept in a dilapidated but centrally located district. Eschewing fancy department stores, Rouse filled his $30 million enclave of renovated warehouses with vendors and small stores—including specially recruited minority businesses—that sell specialty products and foods. Strict surveillance by a large leasing staff maintains quality and aesthetics at Faneuil Hall, and sales per square foot are said to run double those in conventional shopping malls.

Memos from the mayor

Observers who have watched Rouse projects proliferate nationwide commend his marketing savvy as well as his ability to unite disparate government and business interests. He put these skills to work in obtaining government approval and funds for New York's South Street Seaport, scheduled to open this summer after a decade of bureaucratic haggling. And his involvement in the project smoothed the way for a $26.5 million urban development grant. Richard Rosan, who worked on the Seaport project before becoming head of the New York Real Estate Board, says, "Without Rouse we couldn't have gotten the (necessary) support." Rosan says New York Mayor Edward I. Koch, eager to finish the project, kept constant tabs on its progress. "I used to get memos from (Mayor Koch) every two weeks."

Plaudits from politicians and business leaders, in fact, have been the key in lauching Enterprise Development. The undercapitalized real estate company, which will collect 50 percent of the Norfolk project's profits, had to rely on the city of Norfolk to pony up all the financing. Rouse estimates that the company, which has clinched a similar deal in Toledo, Ohio, will generate $1 million for Enterprise by 1988. And feasibility studies are now under way in other small towns, including recession-stricken Flint, Mich. "I think it will work (in small cities)," says developer Paul Reichmann of Olympia & York, who is a Rouse Co. board member. "That type of development creates a very particular place where people will go for the atmosphere, and the shopping will be incidental."

Kindling recoveries

But even Rouse acknowledges that financially, small cities still pose special problems. Anchors, such as a tourist trade and commercial hustle-bustle, are lacking, but the costs are equally high. Says Baltimore housing commissioner M. J. Brodie: "There are not a lot of Disneylands, and I don't suspect there will be a thousand Harborplaces."

Rouse fans, however, are confident that what beautified downtown Baltimore and Boston can kindle a recovery in cities like Flint. Suburbia is no longer fertile ground for retailers, so many are turning to inner cities, according to leasing specialist Michael Hirschfeld, chairman of Garrick-Aug Associates.

For Rouse, Enterprise is the culmination of decades of interest in retailing, urban renewal, and housing. He has sat on numerous Presidential housing committees and since the 1950s has championed slum renewal and planned cities. During the years of America's suburbanization and the civil rights movement, he launched the Columbia project, piecing together a 17,000-acre, racially integrated community. In Columbia, subsidized housing abuts middle-class homes, including Rouse's own modest "Rouse House"—identified by a plaque above the kitchen door. Like Rouse, who moved Rouse Co. to Columbia, residents live, work, play, and collect community health benefits in pastoral surroundings.

Now Rouse wants to adapt some of the principles that worked in middle-class Columbia to impoverished neighborhoods. But Enterprise's impact will not simply depend on the development company's ability to emulate earlier Rouse Co. successes. Investors, lenders, and private benefactors will have to rally behind it. Rouse has already amassed $15 million in donations and challenge grants. He will be getting below-market-rate loans from Equitable Life Assurance Society and others. And he wants to put some of the money to work to get more favorable project terms. For example, Enterprise plans to deposit $100,000 with the United Virginia Bank at 6 percent interest, for which the bank will provide a mortgage at 9 percent for a Lynchburg (Va.) project.

In Denver, a community group wants to raise $460,000—to augment existing private and government funding—by syndicating an ambitious historic renovation to a group of 30 investors. At about $40,000 per unit, the renovation venture is much more expensive than most Enterprise undertakings. The average Enterprise apartment rents at under $200 per month.

Altruism and tax breaks

Investors will get a 25-percent historic renovation investment tax credit, in addition to the usual tax benefits. Because the Denver community group will be the general partner, this syndication may be less risky than other low-income housing projects. But the tax benefits are not as great, according to Michael I. Sanders, a Washington tax attorney with Ginsburg, Feldman, Weil & Bress, because renovation costs are being kept at a minimum. Still, he is confident that Enterprise will find benevolent investors who would like to combine some tax benefit with altruism.

However, as community projects flourish and drive up property costs, Enterprise worries that communities will be unable to repurchase their property. So Rouse is structuring syndications to make sure community groups can buy back buildings once the tax benefits for limited partners run out. In Denver, Enterprise is setting aside a portion of the interest owed on its loan—an amount that could total more than $100,000 after 10 years—with the intention of using the money to help the local group repurchase the property.

Rouse, whose own family home was foreclosed when he was orphaned as a teenager, thinks he can make a big difference in the lives of people like Rosa Hatfield. "I have these fantasies that we will cross a threshold," says Rouse. "This thing is going to become so important . . . we're really going to make a major impact on the life of the poor in the U.S."

While Rouse is coming closer to realizing his dream, there are still tens of thousands of poor people on city waiting lists for new housing. Baltimore Mayor William Donald Schaefer calls Rouse "a visionary" and Enterprise "a marvelous idea," but worries that free-enterprise solutions such as these may provide an excuse for the federal government to retreat further from its responsibilities. Warns Schaefer: "You can't look to the private sector to relieve the federal government and state government."

BOARD OF TRUSTEES OF THE ENTERPRISE FOUNDATION

N. Gordon Cosby, Minister, The Church of the Saviour, Washington, D.C.; Chairman of the Board, Jubilee Housing, Inc.; Vice President, The Enterprise Foundation.

Mathias J. DeVito, President and Chief Executive Officer, The Rouse Company.

Cushing N. Dolbeare, Executive Secretary, Low Income Housing Information Service; President, National Low Income Housing Coalition.

John Gardner, Chairman, Independent Sector, Founding Chairman of Common Cause.

Samuel Gary, Chairman of the Board, Gary Energy Corporation; Chairman of the Board, The Piton Foundation.

Ronald Grzywinski, Chairman of the Board, South Shore Bank, Chicago.

Ernest W. Hahn, Chairman of the Board, Ernest W. Hahn, Inc.

Patricia Roberts Harris, Former Secretary of HUD and of HEW.

Andrew Heiskell, Chairman of the Executive Committee and Vice Chairman, The Brookings Institution; Fellow, Harvard College; Chairman of the Board, The New York Public Library.

Coy Eklund, Former Chairman of the Board and Chief Executive Officer, The Equitable Life Assurance Society of the United States.

Jing Lyman, Founding Member and Director, Women and Foundations/Corporate Philanthropy; Former Trustee and Chair, Foundation Center.

Robert S. McNamara, Former President, The World Bank.

Louis E. Martin, Assistant Vice President for Communications, Howard University.

Leeda P. Marting, Executive Director, John Hay Whitney Foundation.

The Honorable Charles McC. Mathias, Jr., U.S. Senator.

Milton Petrie, Chairman of the Board, Petrie Stores Corporation.

Edward L. Quinn, President, The Enterprise Foundation.

The Honorable Henry S. Reuss, Former U.S. Congressman.

James W. Rouse, Chairman of the Board, The Enterprise Foundation; Chairman of the Board, The Enterprise Development Company; Chairman of the Board, The Rouse Company.

Patricia T. Rouse, member of the Board and Vice President, Health and Welfare Council, Central Maryland; Secretary and Treasurer, The Enterprise Foundation.

Alexander B. Trowbridge, President, National Association of Manufacturers.

Raul Yzaguirre, President, National Council of La Raza.

[Attachment 3]

FINANCIAL CONTRIBUTORS TO THE ENTERPRISE FOUNDATION IN 1982

Alcoa Foundation; Atlanta Richfield Foundation; American Telephone and Telegraph Company; CBS Inc.; Mathias J. DeVito; The Ford Foundation; Ernest W. and Jean E. Hahn Foundation; International Business Machines Corporation; The Joyce Foundation.

Albert Keidel, Jr.; John D. and Catherine T. MacArthur Foundation; McAshan Educational & Charitable Trust; The Andrew W. Mellon Foundation; Richard King Mellon Foundation; Charles Stewart Mott Foundation; Milton Petrie; The Piton Foundation.

Public Welfare Foundation, Inc.; Rockefeller Brothers Fund; David Rockefeller; The Rouse Company; The Standard Oil Company (Ohio); Miriam and Ira D. Wallach Foundation; James W. Rouse.

Mr. QUINN. What I would like to do at this time is merely emphasize two points that are covered in the formal statement.

First, the Enterprise Foundation represents a new creative approach to providing housing, decent housing, affordable for the very poor; and second, that what we have achieved to date would not have been possible without substantial support from private foundations.

The Enterprise Foundation was established by Jim Rouse, a former mortgage banker and real estate developer who had always been interested in the cities of our country and in bringing back life to cities with such projects as Harbor Place in Baltimore, Faneuil Hall in Boston, Gallery at Market East in Philadelphia.

After retirement, he turned his efforts to providing housing for the very poor and established the Enterprise Foundation in 1981. He began operations in the fall of 1982.

It currently is working with local neighborhood groups in 11 cities across the country, and, in light of all the conversations about boards of trustees earlier, I am happy to say that we are blessed with a very supportive board of trustees and one that is quite diverse. There are 8 minorities and women represented on the board of 22.

Chairman RANGEL. Technically, though, you are not really a foundation of the type we are talking about today. Are you not a grantee of a foundation?

Mr. QUINN. Yes. I just thought I would mention that because it has helped us in carrying out our work.

We are a national foundation, a public foundation, working with local neighborhood groups and we provide housing for the very poor through these neighborhood groups. More importantly, the housing is used as a means of reaching the lives of the very poor so that other essential human needs can be addressed such as jobs, health care, and education.

For example, one of the groups we support here in Washington, D.C., Jubilee Housing, has provided 214 units of housing in 5 apartments. Also it established Jubilee Jobs, which this year has a goal of placing one person in a job every working day. By the end of April, it had already placed 104 persons in jobs. Many of them had previously been unemployed.

In addition to working with the local groups to provide housing, the Enterprise Foundation also owns a for-profit subsidiary, the Enterprise Development Corp., which was established by Jim Rouse at the same time as the foundation. Its purpose is to develop commercial real estate projects. All its earnings flow to the Enterprise Foundation to support its charitable projects.

The Enterprise Development Co., however, also has been concerned about the social importance of what it is doing. For example, its first project, the Waterside in Norfolk, Va., opened on June 1, 1983. It has provided 1,350 jobs; of these, 775 were previously unemployed and 470 are minorities, many of whom are living in public housing.

Also, the Waterside Associates employs 56 full-time people; of all these, 50 were previously unemployed black youths. They were tested and recruited and trained by the Southeastern Tidewater Opportunities Industrialization Center.

So the Development Corp., in addition to tying the private enterprise system to social action, has made an important social contribution, too.

Another effort of the Enterprise Foundation is to provide innovative ways of financing housing for the poor without the use of deep Federal subsidies.

For example, in putting together 20 units of housing affordable by the very poor in Denver, it employed private foundation grants, a small low-interest loan from the city, a small grant from the State. The Enterprise Foundation made a loan from its program related investment commitment from the Ford Foundation; and there was also a syndication of the tax benefits sold to what we call benevolent investors, some of the leadership of the Denver community who were willing to invest at a much lower rate of return than would ordinarily be the case.

Third, the foundation is attempting to establish a national system for lowest possible cost in rehabilitation. To make housing affordable for the very poor, the rehabilitation of existing buildings is often—in fact, it is the major way of doing this.

One of the problems is that the rehabilitation has been too costly. Yet, we have found groups in parts of the country doing a very good job using techniques such as partial rehabilitation and, of course, sweat equity, where the people do some of it themselves to bring down the costs. In Cleveland, for example, a single family three-bedroom home, can be acquired and rehabilitated for between $15,000 and $17,000. This makes the housing affordable for the very poor.

We believe that a process can be developed whereby people of good will in this country can make funds available for housing for the poor at no interest or at a small return.

In Chicago a local neighborhood group financed housing for the very poor by selling shares through the suburban churches in very small denominations, $1,500 to $2,000 per unit. The people in the church are buying the shares and then, in some cases, will contribute them to the nonprofit housing group after 3 or 4 years.

So it is a way of bringing together the people of good will in some of the suburban areas by helping with housing for the poor in the inner city.

Our main effort is to build capacity in the local neighborhood groups. In this way the planning and development is done by the residents of the neighborhood.

We don't come in with a prepared plan. We work with the neighborhood to help build their capacity and carry out their plans. We do provide technical assistance, as I mentioned, in both financing and lease cost rehabilitation. We are establishing a network so that the local groups we support can share their experiences.

It is our purpose to create a national system for helping to bring the poor out of poverty and back into the mainstream of American life. This could not have been done without the support of many private foundations.

We received very generous support at the very beginning. We simply could not have launched an effort without the support of many of the major private foundations of the country.

We are very grateful. We are continuing to raise money. Legislation that would help private foundations and encourage the creation of private foundations, would be very valuable. For example, to encourage further private foundation-giving, we support legislation such as H.R. 3043 introduced by Congressman Conable and others to remove some of the impediments to effective private foundation philanthropy and yet not weaken the underlying purposes of the 1969 legislation.

We think this is very important. This bill meets the problems of declining formation of new foundations and would also result in the injection of badly needed funds into already existing foundations.

We know this would be important to the work of the Enterprise Foundation, and, result in benefits to the very poor in our society.

Thank you.

Chairman RANGEL. Thank you.

From the Heritage Foundation, Mr. Feulner.

STATEMENT OF EDWIN J. FEULNER, JR., PH. D., PRESIDENT, THE HERITAGE FOUNDATION

Mr. FEULNER. Thank you, Mr. Chairman. I am Edwin J. Feulner, Jr. I am the president of the Heritage Foundation, a public policy research institute here in Washington, which prides itself like many others on the panel in not accepting any government grants, contracts, awards or reimbursements.

In the brief time allotted to me, I will make one major point about philanthropy in America today, and then I will make several recommendations that, from my perspective, will produce positive change in Public Law 91-172.

My central point concerns the purpose of private philanthropy. Historically, a key role of philanthropy was to promote diversity in American life. Indeed, as De Tocqueville and others have noted, voluntary associations supported by private funds have been essential to social and political pluralism in this country. This has allowed the healthy growth of ideas that are not universally accepted—ideas that, were it not for private philanthropy, might never have been accepted.

The civil rights movement had its first breath of life from private philanthropy. It is private philanthropy that gives sum and substance to the principles of the first amendment by supporting many small magazines of opinion—conservative opinion, liberal opinion, and radical opinion—thoughts in print that would not exist otherwise.

Some people today want philanthropy to merely be the financier of Federal Government programs. These are the people who call for private philanthropy to fill the so-called gap in the funding of these organizations who feel the strain of Federal budget reductions.

To these people I say, private philanthropy must be private. It is not public because it is tax deductible any more than your house is public property because of a mortgage-interest deduction or an appendectomy scar is public because of medical expense deductions. This money is not Government funds for distribution; it belongs to the private individuals from whence it came.

Policymakers should see private philanthropy for what it really is, and stop arguing about what it is not. Private philanthropy is definitely not, let me repeat not, tax avoidance as a major goal. Giving money away is a silly and expensive way of avoiding taxes.

Congress should therefore pass legislation that will encourage the formation and the continuation of private foundations, secure in the knowledge that a healthy charitable community will promote the diverse goals of American society far more effectively than will the Federal Government.

I would like to recommend two specific changes that would do this. First, section 4943 of the code must be abolished. Dealing with the so-called excess business holdings of private foundations, this antiquated section of law continues to promote the old populist notion that it is desirable for the Government to break up family wealth.

This idea has been thoroughly discredited by this and other committees of the Congress in recent years.

The problem is that the constraints of section 4943 are barring the creation of new, major foundations and limiting new, major donations, not just to private foundations, but to hospitals, colleges, and, yes, even public policy research institutions.

The second recommendation I offer for the consideration of the subcommittee deals with providing equitable treatment within the Tax Code for the so-called disqualified person.

Let me describe a brief example of how this law could work: If an individual were to provide a grant of $100,000 to a private foundation and at that time the grant exceeded 2 percent of the foundation's contributions, from inception to date, all lineal descendants become disqualified persons—forever.

Suppose some 30 years later a great-grandson of an original donor were to offer to purchase at public auction land offered for sale by the foundation. Even if he were the high bidder, even if it was a blind auction and the identity of the seller were unknown, he would not be allowed to purchase the land.

If he did happen to purchase the land, even if it was because the foundation did not maintain lineal records and it was later discovered that the buyer was, in fact, a disqualified person, then the owner of the land would be taxed under Federal law, and then he would have the option—after paying the additional tax—of either returning the land—no charge—or paying a penalty tax on the property of 200 percent of the purchase price.

Now, I am not suggesting that this subcommittee recommend that the entire concept of disqualified persons be eliminated. I am suggesting that a few equitable changes be made that will bring the disqualified persons section in line with other tenets of tax law. Most importantly, the subcommittee, I believe, should adopt a "moving 2 percent" rule, consistent with existing tax codes.

By this, I mean that a person or corporation should only be a substantial contributor during a tax year that the contributions exceeds 2 percent of the aggregate private foundation's assets.

Mr. Chairman and members of the subcommittee, I believe these two changes, the elimination of section 4943 and the positive redefinition of disqualified persons, will have an enormous impact that will definitely benefit private philanthropy in America. The public, the people and, yes, even government, would benefit from this responsible action.

Thank you, Mr. Chairman, for your indulgence. I will be happy to answer any questions of the subcommittee.

[The prepared statement follows:]

STATEMENT OF EDWIN J. FEULNER, JR., PH. D., PRESIDENT, THE HERITAGE FOUNDATION

Mr. Chairman and Members of the Subcommittee, before I proceed, I ask the Subcommittee's consent that my entire statement appear in the record and that I may have an opportunity to submit additional remarks for the record as appropriate. I will summarize my written statement with brief remarks:

Thank you, Mr. Chairman.

My name is Edwin J. Feulner Jr., I am the President of The Heritage Foundation, a public policy research institute.

In the brief time allotted to me, I will make one major point about philanthropy in America today and then I will make several recommendations that, from my perspective, will produce positive change in P.L. 91-172.

My central point concerns the purpose of private philanthropy. Historically, a key role of philanthropy was to promote diversity in American life. Indeed as De Tocqueville and others have noted, voluntary associations supported by private funds have been essential to social and political pluralism in this country. This has allowed the healthy growth of ideas that are not universally accepted—ideas that, were it not for private philanthropy, might never have been accepted.

The civil rights movement had its first breath of life from private philanthropy. It is private philanthropy that gives sum and substance to the principles of the First Amendment by supporting many small magazines of opinion—conservative opinion, liberal opinion and radical opinion—thoughts in print that would not exist otherwise.

Private philanthropy is on the front page of every major paper of the world at what is reaching an almost daily basis through its enormous gifts that have made medical breakthroughs possible. And the list goes on.

Today, many people see private philanthropy as a monolithic institution, promoting only one orthodox ideology, one opinion, one idea. This is unfortunate and regrettable. I believe that those people are wrong.

But even worse than that, there are some people—including many in the foundation community—who want private philanthropy to be monolithic, who want it to be one idea, one orthodox ideology.

Some of these people even want philanthropy to merely be the financier of federal government programs. These are the people who call for private philanthropy to fill the so-called "gap" in the funding of these organizations who feel the strain of federal budget reductions.

To these people I say, private philanthropy must be private! It is not public because it is tax deductible anymore than your house is public property because of a mortgage interest deduction or an appendectomy scar is public because of medical expense deductions. This money is not government funds for distribution, it belongs to the private individuals from whence it came.

This money can and should be used to promote the wishes, dreams and the desires of the donors. And the donors can gain all the benefits due them if those wishes, dreams and desires fit within the broad, established guidelines of educational, religious or charitable purposes.

If we allow this to happen, if we allow private philanthropy to be private, then philanthropy in the United States will be diverse, it will promote pluralism and it will contribute to a healthy, democratic society.

More important, Mr. Chairman, you and the Subcommittee have an opportunity to draft legislation that will promote this sort of activity.

Policy makers should see private philanthropy for what it really is . . . and stop arguing about what it is not. Private philanthropy is definitely not, let me repeat not tax avoidance as a major goal. Giving money away is a silly and expensive way of avoiding taxes!

Congress should therefore pass legislation that will encourage the formation and the continuation of private foundations, secure in the knowledge that a healthy charitable community will promote the diverse goals of American society far more effectively than will the federal government.

I could recommend several changes in the present Public Law 91-172, but I will instead concentrate on two of the most onerous burdens that inhibit the growth and development of a healthy philanthropic community.

Section 4943 of the Code must be abolished. Dealing with the so-called excess business holdings of private foundations, this antiquated section of law continues to promote the old populist notion that it is desirable for the government to break up family wealth.

This idea has been thoroughly discredited by respected economic thought and the most recent Sessions of Congress. The history of the accomplishments of private foundations that I alluded to earlier clearly show that when market forces are in control, the society works better.

The problem is that the constraints of Section 4943 are barring the creation of new, major foundations and limiting new, major donations * * * not just to private foundations, but to hospitals, colleges, and yes, even public policy research institutions.

The I.R.S. has had ten years to develop and propose all of the provisions of 4943, and yet to date, significant portions of the code are in the proposal stage and several portions have not yet even made it to the drafting table.

Given the choice between trying to decipher the Dead Sea Scrolls and Section 4943, I pick the Scrolls * * * my ancient Hebrew is not very good, but it is far better than my modern bureaucratese.

Section 4943 does not eliminate the possibility of wealthy individuals avoiding taxes * * * indeed, there are far more creative and less burdensome loopholes in the tax laws. What it does do is to punish those who, through hard work or the right circumstances of birth, desire to use their accumulated wealth to promote organized philanthropy. But more than families such as the Rockefellers and the Fords, Section 4943 punishes most the small and medium sized foundations.

It is these small philanthropic interests that generally provide that invaluable backbone of support within their local communities * * * hospitals, the arts and community funds suffer and will continue to suffer as long as this Section remains in law.

Mr. Chairman, it is these small and medium sized foundations that are the true unsung heros of private philanthropy, who quietly carry on their work for the benefit of the local communities, giving back what was given to them.

To preserve the essence of private philanthropy in America, if this Subcommittee recommends nothing else, eliminate section 4943 once and for all.

The second recommendation I offer for the consideration of the Subcommittee deals with providing equitable treatment within the tax code for the so-called disqualified person.

Again, this is a complex issue, but generally speaking, once an individual or a corporation makes a contribution to a foundation that is in excess of 2% of the foundations assets * * * at the time of the gift * * * that person or corporation and all lineal descendents are once and forever tainted individuals * * * forever to be discriminated against when dealing with the foundation.

Again, another example of a strong disincentive to private philanthropy.

Let me describe a brief example of how this law could work: If an individual were to provide a grant of $100,000 to a private foundation and at that time the grant exceeded 2 percent of the foundations contributions, from inception to date, all lineal desendants become disqualified persons. Forever!

Suppose some thirty years later a great-grandson of a original donor were to offer to purchase at public auction land offered for sale by the foundation. Even if he were the high bidder, even if it was a blind auction and the identity of the seller were unknown, he would not be allowed to purchase the land.

If he did happen to purchase the land, even if it was because the foundation did not maintain lineal records and it was later discovered that the buyer was, in fact, a disqualified person, then the owner of the land would be taxed under federal law, and then he would have the option—after paying the additional tax—of either returning the land—no charge—or paying a penalty tax on the property of 200 percent of the purchase price.

A simple, dramatic, but far from unlikely, example.

Now I am not suggesting that this Subcommittee recommend that the entire concept of disqualified persons be eliminated. Within the structure of the present tax codes there will certainly be strong feelings to prevent individuals from using private foundations as a pure tax avoidance mechanism with the intent to hold their assets for a brief expecting later tax free distribution.

I am suggesting that a few equitable changes be made that will bring the disqualified persons section in line with other tenets of tax law.

First, the Subcommittee should adopt a "moving 2 percent" rule, consistent with existing tax codes. By this I mean that a person or corporation should only be a substantial contributor during a tax year that the contribution exceeds 2 percent of the aggregate private foundation's assets.

If the aggregate contributions of the foundation were to grow and the percentage drops, the person should no longer be disqualified. If on the other hand assets decline and the percentage increases, the reverse would be true.

Second, the lineal descent of disqualified persons should be cut off at the level of grandchildren of the original donor. Obviously, after this point the link between the donor and foundation becomes exceedingly tenuous at best, and an impracticable and onerous burden on all affected parties.

Third, recognizing the unfortunate fact of a significant divorce rate in this country, the automatic disqualified person status should be eliminated for legally divorced spouses and the appropriate lineal descendents. The present system of lifetime punishment for divorced spouses of substantial contributors is unconscionable.

Mr. Chairman and Members of the Subcommittee, I believe these two changes, the elimination of Section 4943 and the positive redefinition of disqualified persons . . . will have an enormous impact that will definitely benefit private philanthropy in America. The public, the people and yes, even government would benefit from this responsible action.

Thank you Mr. Chairman for your indulgence. I will be happy to answer any questions of the Subcommittee.

Chairman **Rangel**. Thank you, Doctor.

What does the Heritage Foundation do?

Mr. **Feulner**. The Heritage Foundation is a thinktank, Mr. Chairman, generally considered to be of a conservative bent. I would add that one of the things that struck me most as I listened to my fellow panelists just now is that our organization, like several of the others described here, were heavily dependent in our formative years—we are only 10 years old—by the willingness of certain private foundations to take risks and to invest in a new think-tank here in Washington, when some people thought perhaps there were already too many of them here.

Chairman **Rangel**. Well, certainly most all of you are past that risk-taking position. You are responsible for charitable organizations and, for those that I know of, rather politically powerful boards.

So, my concern is not the quality of work that you are doing—I am not taking exception with any of the panelists—but whether or not you believe if you had just started today, whether you would be the recipients of the grants. That is what we are concerned about today. It seems to me that because you have built some type of a reputation, that the foundations need organizations such as yours in order to fulfill their Federal requirement.

My concern is whether or not there is enough paid out for charitable organizations such as yours. I don't mean to exclude think-tanks, but I am basically talking about charitable work. I know none of you would disagree if, in fact, the payout was greater it would not hinder your effort.

I assume none would argue either that if we removed the distinction between foundations and public charities, that it would have them competing for the type of dollars that you have received. I mean if the deductions were just as great for the foundations as they are for contributions that you receive, the 50-percent charitable contribution, that would be competitive. You don't believe it would be competitive?

Reverend **Cunningham**. No.

Mr. **Feulner**. I don't think so.

Chairman **Rangel**. In other words, none of you would object if the dollars went directly to the foundation or went directly to you, as long as the donor received the same tax treatment?

Those things we will be trying to work out. How would you suggest that groups proceed that would want to receive grants from foundations, if they were not established as you are. There was some testimony earlier that no one would know where to go.

Did any of you have any difficulty in finding out which foundations ~~would be~~ willing to take the risk with your boards?

Father Cunningham?

Reverend **Cunningham**. Yes; absolutely.

Chairman **Rangel**. Did you have a problem?

Reverend **Cunningham**. We are looking at multi-million-dollar civil rights litigation, Congressman, where we could not get cigarette money to finance it. Some of the things we do, we are prepared to say we would not get that kind of support. We have to, on balance, say that the support came generally from volunteers.

I think my view of the public foundation is that the majority of our support comes from all the little people that like what we are doing where we are, and who are willing to volunteer time and put that $5 or $25 check in an envelope and send it in every month. That is a considerable amount of our support.

I think in terms of foundations, you almost have to get to a certain size. You have to win the credibility in a community before they are willing to throw in with that kind of thing, although there are some who will gamble with a little group.

I don't want to pick one out here, but I remember when we were just starting, we did not have a window or pot to throw it out of. The Kreske Foundation came along and bought us a building. We were not a very, I don't think, looking back—we were not all that good a risk at that time. So, there has been that kind of, we will go along, a-step-with-you sort of thing.

Chairman RANGEL. Sometimes just having a representative of the church there——

Reverend CUNNINGHAM. You mean the collar helps?

Chairman RANGEL. It sure doesn't hurt; wouldn't you agree?

Reverend CUNNINGHAM. Yes, I think that was a good part of it in some instances. But then those who knew me saw that as an obstacle they had to leap over. I think that is true, too. If you have got a fairly radical civil rights priest in the community, are you going to help him? You are, sir. But I mean generally?

Chairman RANGEL. Well, I don't know. I guess what I am talking about is your ability to attract people that are responsible. A former Congressman introduced me to you and obviously he understood.

Reverend CUNNINGHAM. Oh, yes.

Chairman RANGEL. What I am talking about is those who know how to put these pieces together, and Ms. Edelman knows how to put the pieces together and sometimes loses.

Reverend CUNNINGHAM. I am going to be gross, Congressman; I know we are coming to this point. I have just got to say this. I would not help a group that did not have the kind of stuff that knew how to put it together.

I just believe we have to look at winners when we are putting our money out there. I do. And I suspect that we have created pockets for people who did not know how to carry it, didn't know what to do with it.

Chairman RANGEL. Ms. Edelman?

Ms. EDELMAN. Well, I think it is a little harder than that. I think there is a lot more information around than was around 15 years ago when we were just starting, and I think people should be expected to do a fair amount of homework.

On the other hand, I have been very struck by how many talented people there are out in the communities who do not have the first idea of how to go about putting together a thoughtful proposal or finding their way to a foundation. I think that there has to be some mechanism for helping folks, brokering, to make sure you can put folks together.

I think it is hard for somebody starting out now. I am not sure how easy it would be for somebody like me starting out now—even with all of my homework—with all the competing interests. So, I think we do have to find some other ways to strain to be accountable. I think we have to see that foundations try, themselves, to figure out ways to be open to new ideas and new people, and to provide them with some kind of assistance.

On the other hand, I think the burden still is basically on the grantee.

But I think we have to find some way of not just letting those new people and new ideas be left alone, because they do not have the skills and means to do it. And I think there has always been a small minority of foundations that have gone out of their way to try to scout and look out for the people and be responsive and to try to help.

I think there needs to be many more of them. I think we also need to hopefully get more foundations, minority foundations, that have tried to stay responsive over a long period of time, because I think a lot of us have been worried about fadism. Civil rights does not go away just because of political changes.

I have been pleased with those that have stayed for the long haul. There need to be more of them willing to sustain the investments on critical issues of public policy.

We still do have a hard time trying to find foundations who will support litigation or support advocacy. I tend to agree that there is no way the private sector can pick up all the gaps that have come in the enormous cuts in public funding for social programs for the poor and children. But what they can play a role in, I think, is teaching people to stand up for themselves and to advocate for themselves. A number have been too reticent to do that.

Again, I hope that the group of foundations that have been willing to help people help themselves and become effective citizens and to monitor public policies to insure accountability will become a little larger.

I hope that the kind of public airing that is here will encourage what has been a very strong core of support for a lot of risk-taking and can begin to broaden. I hope it will encourage other foundations to strain to be more accountable so that not just winners, but some of the would-be winners, will be looked for a little bit more carefully.

Chairman RANGEL. No greater tribute can be paid to the foundations than the great charitable work that your organizations are doing.

Mr. Pickle?

Mr. PICKLE. Thank you, Mr. Chairman.

I would like to ask a series of questions for information purposes primarily.

I listened to your testimony but was particularly interested in that of Father Cunningham and Mr. Quinn.

I am trying to understand a little bit more. I take it most of you are supported by foundations.

Are your organizations supported by foundations by and large?

Reverend CUNNINGHAM. No, sir.

Mr. PICKLE. I am interested particularly in the statement by Mr. Quinn.

Are you with the Jim Rouse——

Mr. QUINN. Yes, Enterprise Foundation.

Mr. PICKLE. How did it get started? Where did the seed money come from?

Mr. QUINN. The initial money, $1 million came from Jim Rouse. Then the first major private foundation grant was from the Atlantic-Richfield Foundation. Then we have received several private foundation grants since then.

Also, some wealthy individuals have provided support.

Mr. PICKLE. You set out primarily to improve housing for the poor.

Mr. QUINN. Right.

Mr. PICKLE. In turn, that would lead to the alleviation of other human problems and needs. If you are spread all over the country, the holdings must be enormous. I don't know the value of them, but they are all over the country now.

Mr. QUINN. I am sorry?

Mr. PICKLE. Your real estate holdings, apartment units.

Mr. QUINN. That would be the Rouse Co., which is entirely separate from the foundation. The Enterprise Foundation owns no real estate. It does own a real estate development company that is called the Enterprise Development Co.

Again, that is separate from the Rouse Co. The Enterprise Development, the foundation's role in the Enterprise Development Co., is really like an investor.

Mr. PICKLE. I don't mean to infer that the Rouse Co. is a part of this whole operation. I am sure that must be separate, apart. But you started the Enterprise—what do you call it, Enterprise Co?

Mr. QUINN. Enterprise Development Co.

Mr. PICKLE. Is that the same as the Enterprise Network?

Mr. QUINN. No. The Enterprise Foundation has supported local neighborhood housing groups, and we pull them together in what we call the Enterprise Network. So those are the projects we support.

Mr. PICKLE. The Enterprise Foundation, then, goes into a city of Baltimore, and will buy, or build, 10 different apartment buildings or units——

Mr. QUINN. No, sir. What we do when we go into Baltimore, is to work with a local neighborhood group and help them—so that they can acquire units and rehabilitate them, and then find the people that will eventually be residents.

Mr. PICKLE. The objective is a good one, to get apartments, a building that can place 50, 100 people in decent housing. Who owns the apartments?

Mr. QUINN. In many cases the local nonprofit neighborhood group will retain ownership, at least for a period of time,-and then transfer ownership to the resident, if it is a singlefamily or duplex.

Mr. PICKLE. By and large, these residents are people who can't afford housing at all, and they are renters, 99 percent of them, or the big block, I imagine.

Mr. QUINN. We work with people with incomes under $8,000.

Mr. PICKLE. I notice in your statement you said Enterprise, in 1982, assisted whole communities in Denver in developing a financing package that made it possible to restore a gutted building in the neighborhood to productive use as 20 units of low-income housing—without the benefit of deep Federal Government subsidies.

Now that is interesting. And that is commendable. When you gut a building, restore, and remodel it, who is doing the construction?

Mr. QUINN. In the case of the "New Orlando," the nonprofit group, Hope Communities, Inc., retained a minority contractor in the neighborhood. Most of the groups we work with try to develop contractors from the neighborhood. In fact, we have found that has been most effective in reducing the cost of rehabilitation.

Mr. PICKLE. Part of the writeup about Mr. Rouse in Business Week talks about how he has mounted this campaign to build these facilities. He says trading on his famed powers of persuasion and negotiating skills, he is raising money by assembling a grab bag of Government grants, private contributions, tax-sheltered syndications, and below market loans. That is how he put together these projects.

My question to you is, just for my information, When you do a rehab, or facility for housing, does the contractor or unit actually putting it together get accelerated depreciation?

Mr. QUINN. Yes; and many of them, the ones where——

Mr. PICKLE. Do they get investment tax credits?

Mr. QUINN. Well, you can't get both. The one in Denver, because it has historic designation, receives the investment tax credit.

Mr. PICKLE. Do they get interest deductions?

Mr. QUINN. Pardon?

Mr. PICKLE. Do they get interest deductions, also?

Mr. QUINN. Yes, sir.

Mr. PICKLE. If they get a rehabilitation credit, is it the 25-percent tax credit?

Mr. QUINN. Well, they get the 25-percent investment tax credit if it is historic——

Mr. PICKLE. Are these facilities financied by industrial development bonds?

Mr. QUINN. No; the only dollars that came in the New Orlando project from government were a low-interest loan from the Denver Housing Authority and a grant from the Colorado Division of Housing. There have been no tax-exempt bonds used.

Mr. PICKLE. In this particular case, New Orlando might not have used it but in most cases over the country these cities are financing most of these projects by industrial development bonds. If New Orlando did not, you missed out on a good deal. How did that happen?

Mr. QUINN. Well, the groups we have worked with, none of them have used the tax-exempt financing, mainly, I think, because the projects are rather small.

Mr. PICKLE. That may be. It may be the size of it. I imagine, though, if you checked a lot of these, you would see they are financed by industrial development bonds. For the most part when this magazine article says that by assembling a grab bag of Government grants, private contributions, and tax-sheltered syndications, that means the Federal Government is financing most of these projects.

Mr. QUINN. Well, no——

Mr. PICKLE. The public good is being served, but you have to ask yourself is it worthwhile at the enormous cost to the taxpayers?

Mr. QUINN. Congressman, really, that was a Business Week article. They might have exaggerated the role of Government grants. But really——

Mr. PICKLE. It is attached to your statement.

Mr. QUINN. The amount of Government money whether it is Federal, State, or local, is very insignificant in the projects we have been supporting. It is a lot of private foundation money, plus loan money, low-interest loan money we have provided through the Enterprise Foundation. Plus in some cases, forming a syndication to sell units to what we call the benevolent investors so that there would be that equity in the project.

Mr. PICKLE. Does the Enterprise Foundation pay taxes?

Mr. QUINN. The Enterprise Foundation is tax exempt. The Enterprise Development Co. is for profit.

Mr. PICKLE. It is tax exempt. Yet you get all of these other tax credits.

Mr. QUINN. No, we don't get them.

Mr. PICKLE. You are a nontaxable organization; you pay no taxes.

Mr. QUINN. We don't get the tax credits. The local investors——

Mr. PICKLE. The investor or developer gets the tax credit.

Mr. QUINN. Would get the tax credit.

Mr. PICKLE. Do you think these areas would be remodeled if you didn't have these developers getting all these credits and deductions?

Mr. QUINN. I think there might be better approaches for Government-financed housing for the very poor. But at the present time the tax benefits are really one of the few remaining ways to provide affordable housing for the very poor.

Mr. PICKLE. Mr. Chairman, I don't want to extend the hearing. It seems to me——

Chairman RANGEL. No; I think that is a good point. The issue is, in the absence of Federal programs, whether we should have to distort the tax policies the way we do for decent housing. And I agree with you. We shouldn't have to do it.

Mr. PICKLE. Well, we have to ask ourselves, is it a good approach? I am not being critical of the foundation and the work that it carries on, because it serves a very useful purpose. If the foundation was running a project and handling it, that would be one thing. But if the foundation in order to do all this good is, in effect, dependent upon the Federal Government to finance what it constructs, then it is a case of robbing Peter to pay Paul. Then you have to ask what is best, what is the right public policy?

We are going to have to make this decision soon. Not just in connection with foundations, but in the broader picture of municipal financing, and leasing by nontaxable entities.

Chairman RANGEL. You should be congratulated that you have been as creative as E. F. Hutton, and if the recipients happen to be those that need shelter, then I suppose that is just as good as any other group that receives the benefit of tax-exempt bonds. But I agree with Mr. Pickle that we shouldn't have to go that route. However, if the question is whether we are going to have housing or not, I suspect I would be supporting the use of those mortgage revenue bonds.

Mr. PICKLE. Whether or not we give benefits to enterprising developers, becomes a matter of public policy, and what we can afford. Now, I am bringing in a subject that is just related, not really connected with the foundation hearings. So I don't really want to prolong the discussion except I will mention it as a forthcoming problem. Meanwhile I hope the foundation work can be kept strong. It is work that is obviously valuable to all of us.

Chairman **Rangel**. Well, you are the frontline groups. Certainly your testimony is in a tone that recognizes the good work the foundations are doing. We are anxious not to impede that good work, but to provide the type of laws that will allow them to do more to make certain it gets down to the people doing the work that you are doing. Of course where would we be without our think tanks. I guess I can't go any further than that.

The subcommittee will stand adjourned until 9 a.m. tomorrow morning.

[Whereupon, at 4 p.m., the hearing was adjourned, to reconvene at 9 a.m., Tuesday, June 28, 1983.]

TAX RULES GOVERNING PRIVATE FOUNDATIONS

TUESDAY, JUNE 28, 1983

House of Representatives,
Committee on Ways and Means,
Subcommittee on Oversight,
Washington, D.C.

The subcommittee met at 9 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. J. J. Pickle presiding.

Mr. Pickle. The Chair will ask our guests to take a seat and we will proceed with the hearings this morning.

Our first panel consists of several Members of Congress, including some colleagues from our committee. I believe the Chair will ask all the Members to come forward to the witness table. I may ask my friend, Mr. Stark, to proceed.

Mr. Stark. I would be happy to proceed however the committee wishes.

Mr. Pickle. First we have Hon. Fortney Stark of California. Then we have Hon. Mickey Leland from Texas, and Hon. Richard Shelby from Alabama. I believe, Mr. Shannon, Mr. Frenzel, and Mr. Regula may join us as well.

Let the Chair also say to all our witnesses and to our guests that it is the hope of the Chair to hold the hearings continuously through the day. We must be finished by 4 o'clock this afternoon because at that time, and perhaps even earlier, we are hoping to go into markup on another bill.

Therefore, the Chair will ask all the witnesses to please abide by our general rule of 5 minutes. If you will revise and extend and keep your remarks in summation to the 5 minutes, it would be appreciated. If you feel compelled to speak 1 minute longer we would accept that, too.

Now, we will ask Congressman Stark if he would proceed with his testimony.

STATEMENT OF HON. FORTNEY H. (PETE) STARK, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. Stark. Mr. Chairman, it is a pleasure to testify here today. I have submitted a written testimony which I ask be made part of the record, and I will try and highlight some of it for the committee.

Mr. Pickle. Your entire statement will be made a part of the record, Mr. Stark.

Mr. **Stark**. The three concerns which I think should be brought to the attention of the committee are the excess business holdings, the question of trustee compensation, and the life of foundations. They are the three issues I would like to address.

I think this committee basically has to decide whether, from a social policy perspective, we should have an unlimited preservation of capital with a low level of income payout to meet society's needs and whether we might not be better served to limit the lives of foundations and increase payout over a shorter time.

It is my feeling that if some well-to-do person cannot memorialize his or her basic ideas in over 30 years, there is no way that the second and third generation children are going to do it. Nor are hired hands out of academia going to necessarily take the ideas of a philanthropist and improve on them.

The press has recently highlighted the Keck Foundation where one trustee received compensation of over $1 million a year. I think that is enough, that summarizes my concerns about the compensation of trustees. It is conceivable that many years after these foundations are founded that people running them could have other motives and incentives than to distribute money to charities. I think it is important to remember that there was only one reason for these foundations to be granted tax exemption, only one, and that reason was to give the most number of dollars to the most citizens. Any other consideration, whether it is running a newspaper, or any other kind of business, was not the intention of Congress.

We gave a huge tax exemption with the idea that this money would get to charitable recipients and no other reason. Anything in the tax code that would create some other situation I think should be avoided.

The divestiture question arises—and you will hear most of the testimony on that—I think it is clear there have been some 1,600 foundations that have complied over the years. There are a few who are coming here and begging for forgiveness or begging for exemption. Their cases are without merit. There isn't a one that, on any grounds, could merit this committee's making an exemption. I will mention just a few foundations.

The Public Welfare Foundation, 97 percent of whose assets consist of three newspapers, the Spartanburg Herald, Gadsden Times, those two among them, spend a little less than $4 million a year. Their assets are $90 million. If they sold those assets and only received 10 percent, which they could do in Government bonds, they could increase their contributions to charity by $5 million a year. Now what reason could this committee have for denying charitable recipients the $5 million a year that these people could distribute?

The Houston Endowment will be back to see us; the Chronicle spends $4 million a year. That paper is worth $150 million. If they sold it and invested the money at 10 percent they would get $15 million a year and you would have $11 million more a year for the people of Houston in charitable contributions. The paper would still go on under the hands of new owners.

The New London Newspaper owned by the New London Dade Foundation spending $175,000 a year, worth $16.5 million, if you invested the assets you would get $1.7 million and pick up about a million-and-a-half extra for the people of New London.

The Otto Bremmer Foundation owns a bank. The bank is valued at around $25 million, gives about a million a year to charity. If you sold the bank, you could more than double the contributions to charity.

I cite these people because the total for the 3-year life of this bill would be $72 million additional charitable contributions. I don't see any way that this committee could deny deserving people those kinds of contributions. So that I would urge the committee to not weaken any of the divestiture requirements that are in the law and I ask that these figures be made part of the record and I would be glad to answer any questions.

[The prepared statement follows:]

STATEMENT OF HON. FORTNEY H. (PETE) STARK, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. Chairman, it is a pleasure to be here today to testify on the subject of private foundations. The Committee faces a broad range of issues, in this the first major review of private foundations since 1969. I will limit my testimony to three areas on which I have specific concerns. These are: divestiture of excess business holdings, trustee compensation and foundation life.

No one doubts that foundations serve an important role in our society. They provide a non-governmental source of funds for a wide range of useful social purposes. Foundation grants fund many of our important national institutions in the fields of art, education and medicine. These grants occasionally have been the basis for new and innovative approaches to social problems, although all too often foundations have tended to favor traditional organizations.

Any discussion of foundations must begin with a decision as to what the purpose of a foundation is over time. It seems that there are two basic views in analyzing foundation life. Some argue that we provide a method of unlimited protection of capital so that the income therefrom will always be available to serve the foundation's goals. This is clearly the dominant opinion. In past Congresses, legislative battles over the payout requirement have shown that protection of capital rather than maximizing current grants are the foundations' primary goal. I do not say this merely to be critical. Self preservation is an instinctive reaction for any organization. I think, however, that this Committee should consider whether, from a social policy perspective, unlimited preservation of capital with a low level of income payout best meets our society's needs. We might well consider if we would be better served by a limited life for foundations with a much greater payout over a shorter period of time.

I argue for limited life not out of any basic dislike for foundations. I do not consider, as some do, that private foundations are mere instruments of privilege through which the wealthy reach past the grave to impact society in a manner consistent with their views. I do, however, subscribe to philanthropist Julius Rosenwald's view that we should look to each generation to provide the resources necessary to meet the social needs and problems of that age. I think that as a matter of social policy, we should encourage those with great wealth and good intentions to concentrate their resources on the problems that they see and can reasonably project into the future. Such an approach guarantees that the resources of the foundation will most efficiently serve the benefactors' intent. It will assure that capital, as well as interest income, will be expended for the charitable purposes intended. It will provide larger grants to attack current problems and will prevent institutional stagnation and obsolescence.

Suggestions for limited life while controversial are of course not new. One of Congressman Patman's Subcommittee on Foundation's first recommendations in 1962 was that foundations be limited to a life of 25 years. I hope that the Subcommittee will weigh the advantages gained by limiting foundation life. Should such an approach be taken, careful attention should be paid to assuring that we encourage, as much as possible, formation of new foundations to replace those that would expire over time.

Trustee compensation is an area in which the Federal government has not involved itself in the past. This has been left primarily to the States who, through their Attorneys General, protect the general public. There are, of course, some cases which are clearly extremely abusive. The press has been recently highlighting the

W. M. Keck Foundation where compensation for a single trustee was over $1 million a year. An overview of trustee compensation can be gleaned from the 1982 report of the Council on Foundations, "1982 Compensation Benefits Report." Over half of the largest foundations provide members of their boards with compensation. These range from a mean of approximately $7,000 to a high of $30,000. While astronomical trustee compensation is not a pervasive problem, clearly even the mean of $7,000, often for not more than 100 hours of meetings a year, is getting into the excessive range. Furthermore, compensation costs are credited toward meeting a foundation's payout requirement and therefore have a direct and immediate impact on grants.

We provide tax favored status for a foundation to assure that its funds are used for charitable purposes. Foundations, in my opinion, have a duty to be both watchful and conservative in establishing levels of compensation. I would hope that the subcommittee would send a clear signal to the foundation community in this regard.

There is broad agreement that the 1969 Act has been very effective in eliminating much of the abuse that existed in the area of private foundations and has provided broad protection of the public interest. Section 4943 of the Internal Revenue Code, a product of the 1969 reforms, requires new foundations to divest themselves of excess business holdings within 5 years. For existing foundations, section 4943 provided extremely generous transition rules to allow foundations time to divest themselves of business holdings in excess of a 20 interest in the voting stock of a corporation. The amount of time allowed for divestiture was based upon the percentage of the business controlled by the foundation. Foundations with more than 95 percent of a corporation's stock had 20 years to bring their holding down to permissible levels. Section 4943 was enacted to prevent foundations from being a guise for the operation of a business and to assure that foundation investment decisions were based on sound investment policy rather than a tie to the donor's original business. These divestitive requirements were, of course, all the more critical given the unlimited life of foundations and the potential for abuse over time when a foundation is too closely tied to a single business. Over the past 14 years, thousands of foundations have complied with the divestiture requirement. I think that most would agree that the overall effect of divestiture has been positive. Abuses of the past have been curbed and foundations have remained solvent and probably more independent. Several foundations, however, have resisted divestiture. They have turned again and again to the Congress seeking special interest legislation to exempt themselves from the requirements of the law. One or two foundations that are attempting to comply may have a specific problem divesting within the time limits under the law. Short term relief may be necessary. The other foundations involved, however, have ready saleable assets which they merely wish to retain. These range from a hotel in Colorado to a newspaper in Texas. These cases are without merit. The ferocity with which these foundations cling to these specific assets proves the wisdom of the underlying rule. It should reinforce our conviction that a foundation's priority is not the preservation of any specific asset, but rather to serve the public through its grantmaking function. Important as hotels and newspapers are, they are not charitable activities. I hope that the Subcommittee will appreciate the wisdom behind section 4943 and not recommend any weakening of the divestiture requirement.

Mr. PICKLE. Thank you, Mr. Stark.

Now we will ask Mr. Leland from Houston to proceed.

STATEMENT OF HON. MICKEY LELAND, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. LELAND. Thank you, Mr. Chairman.

It is rare that the gentleman from California and I are on different sides. In principle we are in the same place, but I appear in support of H.R. 2598. I am a cosponsor of this legislation as are most of the members of the Texas delegation as well as the delegations from Alabama and South Carolina.

This bill is intended to permit Houston Endowment Inc. and Public Welfare Foundation to continue to own newspapers which they have owned for many years. I am intimately acquainted with the situation involving Houston Endowment Inc. and my remarks are based on personal knowledge of Houston Endowment.

Houston Endowment is a charitable foundation established by Jesse H. Jones. During his lifetime, Jesse Jones was one of the leading citizens of our country. He is perhaps best remembered for his service during the Roosevelt administration as Secretary of Commerce and as head of the Reconstruction Finance Corp.

His remarkable career of public service notwithstanding, Jesse Jones is best remembered in Houston for his compassion and commitment to community service. The record of the foundation he established provides eloquent testimony to that commitment.

Since it was founded in 1937, Houston Endowment has given away for charitable purposes more than $214 million. This money has been devoted to education, medicine, the arts and general public welfare.

I am keenly aware of the foundation's record with regard to the minority community in Houston. The endowment has made it possible for many minority children, black and Hispanic, to attend college through a scholarship program which reaches out to every high school in the community. I was a candidate for the Jones scholarship, I was an alternate. You know what happens to the alternates for scholarship funds.

The endowment has been involved and has generously supported programs for the aged, young offenders and others in need.

Houston Endowment provided critical assistance when the six developing colleges of Texas, which are primarily black colleges, badly needed financial support. For the past four decades, the endowment has provided financial assistance to Prairie View A&M University, a black institution associated with the Texas A&M University system.

The commitment to community which was a hallmark of the public life of Jesse Jones, and is reflected in the good works of the endowment which bears his name, is also reflected in the endowment's ownership of the Houston Chronicle, a daily newspaper published in Houston. The Chronicle's reputation as a respected, independent voice for all of the people of Houston is richly deserved. It is in this context, Mr. Chairman, that I believe the divestiture provisions of the Internal Revenue Code must be examined as regards their protection of the public interest.

Consider first that the Houston Chronicle, the largest newspaper in Texas, is in close competition in Houston with the Houston Post, also locally owned and published. It seems to me that competition in the marketplace of ideas is in the public interest and the thriving competition that exists between the daily newspapers in Houston is due in large measure to the strong community identity and interest that comes with local ownership.

It is a fact of life that when major newspapers are sold, regardless of the impetus for that sale, the large newspaper chains are the ready buyers with the most money. It seems to me that a locally owned daily newspaper with a rich tradition of community involvement, which hallmarks the two major newspapers in Houston, is preferable to a newspaper owned by a chain. That comment is not intended to be critical of existing newspaper chains but rather a reaffirmation of the obvious: Local identity is a matter of fact and tradition that cannot be purchased along with buildings and presses. The interest of the people of Houston is clearly best served by allowing continued local ownership of the Houston Chronicle.

We must also consider that the divestiture provisions of the Internal Revenue Code, in my judgment, abridge the first amendment rights of the Houston Endowment and Public Welfare Foundation by denying their ability to own and publish newspapers. I am not persuaded that any public interest is served by these provisions. Indeed, the most identifiable impact on divestiture, as I have mentioned, is to encourage the concentration of ownership of newspapers by chains.

It is my belief, Mr. Chairman, that if we are to apply the divestiture provisions of the code to the Houston Endowment and Public Welfare Foundation and at the same time serve a real public interest, we must do so only in the event that a compelling argument is made that the public interest in general, and the best interests of the people in Houston in particular, will be best served by the loss of local ownership of one of its two major daily newspapers. I have heard no such argument and I don't expect to. The public interest in this matter will be best served by modifying the code as provided in H.R. 2589.

Mr. PICKLE. We thank you, Mr. Leland. We appreciate your testimony.

Mr. Shelby, we will be pleased to hear your statement.

STATEMENT OF HON. RICHARD C. SHELBY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ALABAMA

Mr. SHELBY. Thank you, Mr. Chairman.

I would like to submit my statement for the record.

Mr. PICKLE. Without objection.

Mr. SHELBY. Mr. Chairman, I represent the Seventh Congressional District of Alabama. The city of Tuscaloosa comes within my district and is my hometown. Our local newspaper is the Tuscaloosa News. Its editorial, reportorial, and management personnel, as well as its entire staff, are comprised of people located in Tuscaloosa and who exercise full control over the newspaper's editorial policies. It has been so for more than the past 35 years.

The Tuscaloosa News' owner, however, for that same period has been Public Welfare Foundation, a private foundation. That foundation also owns and has owned the Spartanburg, S.C., Herald and Journal and the Gadsden, Ala., Times, for approximately that same period of about 35 years.

In my experience, the Tuscaloosa News has always been a good corporate citizen of our district. And, it has, in my observation, employed good business practices without, in any sense, abusing its parent's tax exemption. Moreover, I am informed, the Tuscaloosa News has paid full corporate income taxes on its earnings before the payment of any amounts to its parent, the foundation. The foundation, in turn, has been a generous benefactor of charitable and educational projects within our district and the newspaper's personnel have actively participated in local affairs. I believe the same can be said of the foundation's other newspaper subsidiaries, the one in Spartanburg, S.C., and the one in Gadsden, Ala.

I am cosponsor of H.R. 2589 which is intended to eliminate the requirement, presently provided in the Tax Reform Act of 1969, which would compel Public Welfare Foundation to dispose of its ownership of the Tuscaloosa News and its other papers.

I cosponsored this bill because I anticipate that were the foundation required to dispose of its ownership of the Tuscaloosa News, and to do so at a price consistent with its fiduciary responsibility to obtain full fair value, such disposal probably would result in the further concentration of ownership of the media by large chains, as was mentioned by my colleague from Texas, Mr. Leland.

And such further concentration, I believe, is not consistent with either our local or the national interest. I also fear that this could remove from Tuscaloosa the management, editorial and reportorial control which now is local. And such disposal also can be expected to diminish both the community participation and local charitable efforts of both the newspaper itself and its parent, the foundation, the Public Welfare Foundation.

For these reasons, I think it to be the best interest of our community if the foundation were permitted to retain its present ownership of these newspapers.

I therefore request that this subcommittee view with favor H.R. 2589 which I have cosponsored.

Mr. PICKLE. Thank you, Mr. Shelby, for your statement.

I would ask that our colleague, Mr. Shannon, from Massachusetts, proceed with his statement.

STATEMENT OF HON. JAMES M. SHANNON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MASSACHUSETTS

Mr. SHANNON. Thank you, Mr. Chairman.

Mr. PICKLE. Do you have a prepared statement?

Mr. SHANNON. I have a prepared statement.

Mr. PICKLE. You are always prepared.

Mr. SHANNON. Thank you, Mr. Chairman.

I appreciate the opportunity to appear before you today. I would like to discuss two bills related to private foundations and why I feel they are needed at this time.

The first of these bills is H.R. 3043, a bill that I introduced with Mr. Conable, Mr. Frenzel, and Mr. Gephardt that would amend tax law provisions that currently serve as a disincentive to gifts to foundations and foundation philanthropy. As I am sure you know, throughout this century foundations have played a special and important role in responding to the needs of our society. However, the restrictions that our bill addresses have been eroding foundations' capacity to make similar contributions in the future.

To appreciate the importance of this legislation, one need only consider some of the ways in which our lives might be different if foundations did not exist. For example, without foundation-funded research, we might still be living in fear of polio, typhus, and malaria, and in ignorance of the workings of DNA. Without sustained foundation funding, the thousands of black college students who have attended the colleges served by the United Negro College Fund might have been denied an education and the opportunity for fuller participation in American life. Without massive foundation grants, public television in this country might have died in its infancy. The list could go on, but these examples should provide an idea of how the quality of our lives and the openness of our society have been enhanced by private foundations.

Those who share my belief in the importance of foundations must also share my concern about the decline in foundations' grantmaking capacity. Since 1969 the birth rate of new foundations has dropped sharply. During the 1970's only one-third as many new foundations were established as during the 1960's. Lifetime giving to private foundations has also dropped precipitously, to only a fraction of the pre-1969 level. Between 1969 and 1981 the value of foundation assets—and thus their future grant capability—measured as a percentage of GNP has dropped by 40 percent.

These alarming trends stem largely from the unfavorable tax rules applying to lifetime gifts to foundations. For example, under present law if a donor gives stock purchased for $10 and now worth $100 to a public charity, he can deduct $100. Donors to public charities can take deductions for their gifts up to a much higher percentage of income than can donors to private foundations; and they can carry over excess deductions to future years while donors to private foundations cannot.

These discriminatory tax rules are an unfortunate anachronism. As the legislative history makes clear, enactment of these restrictions reflected congressional concern that under the law as it existed prior to 1969, some foundations were not using their resources actively and exclusively in the public interest. However, in 1969 Congress addressed these concerns directly by subjecting foundations to a comprehensive set of legal restrictions, including mandatory distributions and stringent prohibitions on dealings with related parties. These rules were intended to guarantee that all funds given to private foundations be used for charitable purposes, and they have been most effective in doing so.

Accordingly, the restrictions on giving to foundations are no longer needed and should be repealed. H.R. 3043 accomplishes this objective by making contributions to foundations deductible on the same basis as gifts to charities. In addition, it makes four technical changes in the private foundation rules that would enable these foundations to operate more easily without affecting the purpose of the rules: limiting the definition of "family member" to children and grandchildren of disqualified persons, rather than all lineal descendents; allowing the foundation to rely on official IRS rulings recognizing the tax-exempt status of potential grantees; applying the detailed recordkeeping and reporting requirements only when total grants to a particular grantee during a given taxable year exceed $15,000; and allowing the Secretary of the Treasury to abate first-level penalty taxes when a violation of the rules was due to a reasonable cause and was corrected within the statutory period.

I believe that these changes in the rules which are currently restricting private foundations would be a major and necessary step toward insuring that these foundations can continue making contributions to all aspects of American life. At a time when there have been drastic reductions in funding for government-supported activities, it is especially important that we provide all the encouragement we can to privately funded philanthropy.

The second bill I would like to discuss is H.R. 2138, a bill that I have introduced along with Mr. Conable and Mr. Gephardt to eliminate the application of the private foundation rules to certain museums and libraries which, except for some unusual financial circumstances, would be eligible for public charity treatment. It is my belief that the private foundation rules were not intended to apply to organizations such as these.

Under present law, museums and libraries must satisfy certain standards of public support in order to be classified as public charities. In general, the public support test is satisfied if the institution receives at least one-third of its total support from public sources, or if it satisfies a facts and circumstances test in which at leaslt 10 percent of its financial support comes from such sources and it maintains an active program to solicit funds from the general public. Institutions failing to satisfy these requirements are classified as private foundations and are subject to the whole panoply of rules that accompany this classification.

Unfortunately, the mechanics of this test have caused a number of museums and libraries to be classified as private foundations despite the fact that they receive their contributions from public sources, maintain continuous public solicitation efforts, and have a high degree of public accessibility and accountability.

In a typical case, an institution may happen to receive a large endowment in the form of a trust. The trust may produce such a substantial amount of income that the amount of public support relative to the institution's overall income may be reduced below the requisite level for public charity status. The institution is then forced to either accept private foundation status or to attempt to obtain more public funding—money which it may not need and which could be donated to more needy institutions but which is necessary to maintain the required public-to-private ratio. This results in a misallocation of charitable donations.

If the institution accepts private foundation status, it finds itself faced with a series of restrictions and requirements which it would not otherwise have to follow. As these institutions will tell you in their testimony, they have no problem with most of these rules and follow them anyway. However, the recordkeeping burden imposed by the expenditure responsibility rules, and the 2-percent excise tax on net investment income pose severe financial and administrative problems for many of them. And because these are publicly oriented institutions, not subject to the abuses which necessitated the private foundation rules, this burden is entirely unnecessary.

H.R. 2183 would extricate these museums and libraries from their dilemma by granting them public charity status as long as they meet certain requirements to insure public involvement and accountability. In the case of a museum, 25 percent of its governing board would have to consist of community leaders, public officials, or individuals selected by public officials. The museum would have to, as its principal function, employ a professional staff for the exhibition of tangible objects to the general public on a regular and continual basis for free or at a nominal charge.

A library must have been established by a law of the United States, a State, possession, or the District of Columbia, or have been established before 1989; and must be operated by an organization as a permanent part of its public services. It must also be open and available to the general public at no charge and be operated by an organization whose income is expended only for the construction, maintenance, expansion, operation, or management of the library.

The museums and libraries affected by this legislation are mostly small institutions with specialized collections that provide a unique perspective on some aspect of American life. Often they serve to record and preserve the history and character of the communities in which they are located. An example from my own area is the Merrimack Valley Textile Museum in North Andover, Mass. Through exhibits that include working models of old looms and textile machinery, this small museum provides the citizens of the Merrimack Valley with a knowledge of the industry that was essential to the development of the area in which they live. Small institutions such as these play an important role in the overall framework of American culture. They should be allowed to operate free of unnecessary constraints.

In sum, while the private foundation rules are generally working well, there are some areas where their application has imposed a burden on certain institutions that is no longer, if it ever was, justified by the potential for serious abuses. I believe that Congress should act to remove these unnecessary burdens so that these institutions may continue to thrive and to serve the public.

Mr. PICKLE. Thank you, Mr. Shannon.

Now we will ask our colleague, Mr. Frenzel, if he would proceed with his statement.

Do you have a statement, sir?

STATEMENT OF HON. BILL FRENZEL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Mr. FRENZEL. Mr. Chairman, I have a statement. I ask that it be made a part of the record and that I be permitted to proceed.

Mr. PICKLE. Without objection.

Mr. FRENZEL. Mr. Chairman, I maybe wouldn't have come today if I had known Mr. Shannon was going to make such a splendid presentation in favor of his bill, H.R. 3045, of which I am a cosponsor.

However, I would like to endorse his statement with the exception of the small textile museum whose presence I was unaware of until this date.

But I would like to make a few other comments, Mr. Chairman.

The first of these is one I have made for the last 3 years, and that is that in 1969, as a result of pressures coming from people who thought foundations were a creation of the devil, we made a major revision of foundation law. Some of those changes were made, I think, precipitously. Since then there has been but one change, to limit the payout to a maximum of 5 percent. That in my judgment, was a very important improvement in the law, but it was made as a matter of urgency because inflation had created quite a different set of conditions than those which existed in 1969.

I think it is now time to review the entire foundation law, and I hope the committee does it in a leisurely and very careful fashion.

I believe that some of the restrictions that we put on in 1969 were either unwise at the time or at least are unwise now. For that reason I sponsored H.R. 974, and I also cosponsored Mr. Shannon's bill which contains many provisions which are similar. I am not going to repeat Mr. Shannon's testimony except to say that I think the key distinction we have made is to eliminate the difference between contributions to private foundations and contributions to public charities. In general I think it would be good if we erased that particular distinction. I do endorse H.R. 3043 and all the provisions of my bill which may be absolutely different. I believe it is an important thing.

With respect to the testimony of our colleague Mr. Stark which I read but did not have a chance to hear, I think he raises a good question. I think that foundations need a critical look, they need supervision and oversight just like any other element in our society. I am not as vigorous in demanding an immediate answer to the longevity problem. In fact, I hope it is not one that this committee attempts to decide in a hasty manner. I think it is something you don't do in a year but I think it is well that the problem be looked into. I applaud the subcommittee's willingness to look into all these matters.

I have two special cases. One is the Otto Bremmer Foundation of St. Paul, Minn. This is a case that might meet one of Mr. Stark's conditions, that is, it is caught in a bind between the foundation laws and the banking laws and regulations, and cannot meet the time requirements of the law. The committee has looked at this foundation's problem in the past. I assume you will look at it again. In my judgment, and I think in the judgment of many members of the committee, it is one that needs extra time or some kind of solution other than it can get in enforcement of today's law and regulations.

I have a second case, Mr. Chairman, the Olin Foundation, which owns and operates the Federal Cartridge Corp. and is headquartered in the town of Anoka, Minn. There the question is not necessarily the ability of the foundation to sell the operation. It is rather that in a town of 16,000 the plant provides jobs for 2,300 people. The fear is that if the operation were to be sold, the production facilities would be moved elsewhere. The town and the operation corporation have been a symbiotic relationship for many years. That is an industry in which there are only two other competitors in the United States. There is some question as to the antitrust impact of a sellout, and I think that merits some special attention, or at least an extension from this subcommittee.

Mr. Chairman, again I thank you for the opportunity to testify and I yield the balance of my time.

[The prepared statement follows:]

STATEMENT OF HON. BILL FRENZEL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Mr. Chairman and Members of the Subcommittee, thank you for providing me with this opportunity to testify on the tax treatment of private foundations.

As several of the witnesses yesterday pointed out, there has not been a comprehensive review of the tax treatment of private foundations since 1969. A lot has happened over the last decade or so, and I believe that the changes that have taken place in the operation of private foundations definitely warrant a reveiw so that the tax laws can be adjusted to reflect the new conditions.

The foundation provisions of the Tax Reform Act of 1969 were enacted in a climate of general suspicion of all private foundations; both of the purpose behind creating foundations and of the beneficiaries of foundation distributions. The resulting restrictions were somewhat severe, and no doubt resulted in the termination of some foundations whose charitable credentials were never in doubt. On the whole, however, the 1969 Act did have the positive effect of insuring that all foundations that could comply with the requirements of the Act would, in the future, carry out the charitable purposes for which foundations were created.

In view of the changes that have taken place in the activities of private foundations since the enactment of the 1969 Act, I strongly believe that some of the restrictions which have historically been placed on private foundations, or which were enacted in the 1969 Act, now need to be modified. In that regard, I have sponsored a bill, H.R. 974, which makes several modifications in the current foundation tax laws. I have also co-sponsored H.R. 3043, a bill introduced by my colleagues Representatives Conable, Gephardt and Shannon, which contains several provisions similar to those in H.R. 974.

One change in the current law which I think is vitally necessary is to eliminate any tax distinctions between contributions to private foundations and contributions to public charities. These differences, which limit the amount of a taxpayer's income that may be contributed to a private foundation as compared to a public charity, and which provide for differing treatment of contributions of capital gain property to private foundations vis-a-vis public charities, have the effect of stifling contributions to private foundations, and of artificially creating distinctions between structurally different charitable organizations where no real distinction exists.

At one time, it may have been appropriate to have the distinction that exists between the tax treatment of contributions to public charities and the tax treatment of contributions to private foundations. Since the enactment of the reforms of 1969, however, and the subsequent changes private foundations were forced to go through, the major reasons for the public charity/private foundation tax distinction have, in my judgment, been eliminated.

My bill, and H.R. 3043, also contains several other provisions. I believe that these provisions are changes which are necessary to provide private foundations with sufficient lattitude to continue to do their fine charitable work, without undoing the necessary restrictions that insure that private foundations are not used as an abusive means of tax avoidance. These provisions include:

(1) Modification of the rules that treat any lineal descendant of a disqualified person as a disqualified person;

(2) Abatement of the first-tier penalty tax in cases where the prohibited transaction has been certified to have been due to reasonable cause and is inadvertant;

(3) Elimination of the expenditure responsibility rules for grants totalling less than $15,000 per year;

(4) Excluding from income subject to the excise tax all capital gains income; and

(5) Allowing ordinary and necessary expenses of producing investment income to be considered qualifying distributions for purposes of the pay-out requirement.

I am also concerned about the problems that some foundations are having in complying with the divestiture requirements enacted in the 1969 Act. In the case of at least one foundation in my district, the Otto Bremer Foundation, the foundation has given all indications that it is willing to comply with the requirements of the law. Because, however, the business holding involved is a bank-holding company, comprised of many small, rural banks, and because of the lack of regulations from the IRS on section 4943 of the Internal Revenue Code, the foundation has been having difficulty in divesting within the time limits provided for in the 1969 Act. The foundation, as one of its trustees will explain on Thursday, is not asking for an exemption from the divestiture requirements. It is simply seeking a few more years with which to comply.

Another foundation I am concerned about, the Olin Foundation, owns and operates the Federal Cartridge Corporation, which in turn operates the Federally owned Twin Cities Army Ammunition Plant in Minneapolis. The Federal Cartridge corporation plant provides jobs for 2,300 people in the town of Anoka, a community of only 16,000 people. It is by far the largest employer in the community.

In this case, the foundation trustees feel that, if the company were sold, operations would most likely be consolidated with another company, and the Anoka facility shut down. There is also concern that there might be anti-trust problems with any of the potential purchasers that might be qualified to take over operations, since there are only two principal competitors to the company. The Foundation has requested that it be given an exemption from the divestiture requirements, and I will be introducing legislation to that effect today.

Mr. Chairman, the size of the witness list for these hearings clearly indicates that there is a need for some changes to be made in the tax laws governing private foundations. The amount of interest also demonstrates that there is a high degree of concern as to the outcome of these hearings. I think that you and the rest of the Members of this Subcommittee are to be commended for holding these timely and necessary hearings, and I look forward to working with you in developing a responsible bill that addresses the current problems of private foundations.

Thank you.

Mr. PICKLE. Thank you, Mr. Frenzel. That was a very good statement.

Now we will be pleased to hear from our colleague from Ohio, Mr. Regula.

STATEMENT OF HON. RALPH REGULA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. REGULA. Thank you, Mr. Chairman.

I ask unanimous consent to make my statement part of the record and I will try to summarize.

Mr. PICKLE. Without objection.

Mr. REGULA. I am here with a different concern not addressed to any specific foundation but I commend the subcommittee for holding the hearing on this subject. I think in 1983 many conditions have changed that would make it important that the whole problem be addressed.

My concern is the impact that the existing law has on takeovers and what I mean by that is that because of the restrictive nature of the law many times corporations with family members that are very active in the company have a—find more difficulty in resisting takeovers in the present way that the law is structured.

For example, I think that the law requires a more realistic definition of what is a disqualified person, or what are disqualified persons. The social impacts of takeovers are very considerable, particularly on smaller communities because obviously if a company that has had a very substantial economic and social impact on a community is taken over, oftentimes outside management is brought in and they no longer have the interest in participating in community activities, the churches, the Boy Scouts, the hospitals, the colleges, and so on. It becomes solely a matter of how much profit can be made and drained out of that community.

Oftentimes as a result of takeovers whole factories or operations will be lifted from the community and moved to another area and if it is a community that is heavily dependent on that particular industry it has an extremely debilitating impact on the economic base of the community.

It seems to me that in 1983 as we look ahead that we need to be concerned about the maintenance of community-based industries and the very valuable impact that these have on providing a pool of leadership in the community for many worthwhile activities, the very important impact they have in providing a stable economic base and stable employment.

In addition, the foundations tied to community-based industries likewise have a keen interest in providing seed money for community activities, for providing a stimulus to the development of many worthwhile projects, and if, because of the collective impact under the present law of determining what are disqualified persons you could oftentimes have foundations put in a position of having to sell their stock under a distress kind of situation. I don't think that is a healthy thing for the communities involved, either.

It is interesting to know that W. T. Grimm & Co., which tracks merger announcements, reported in 1981 merger activity increased 27 percent in 2,395 transactions compared with 1,889 a year earlier. The Grimm Co. reports that acquisitions of small, privately held companies are the focal point of the mergers. Of the 2,395 transactions tabulated in 1981, 56 percent involved the sale of closely held firms. This figure represents an increase from 52 percent in 1980.

The data collected by this firm in 1981 reflected the highest number of hostile tender offers that Grimm's company has ever recorded. Another trend suggests it is the well-managed firms that are frequently the targets. Therefore, I say to the subcommittee, I hope you will take a total look at the impact of the existing law as it causes takeovers and makes it difficult to resist them if they are hostile and take a look at the social and economic impacts of this trend and what has been created in terms of the local communities across the country and the impacts that this kind of takeover might have on the leadership and economic base.

I don't think the tax laws should purposely become a tool to force the sale of local businesses and adversely affect the quality of life in communities which have been well served by local family-owned businesses and their foundations.

I certainly would urge the committee to consider revisions in section 4943, particularly as they impact on this problem of takeovers. I thank you for this opportunity to bring the problem to the attention of the subcommittee.

[The prepared statement follows:]

STATEMENT OF HON. RALPH REGULA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. Chairman, I appreciate the opportunity to testify before your committee today.

I wish to address the very serious problem of takeovers of family-owned businesses by conglomerates. Conglomerates typically do not feel the ties to a community that are a large part of a family business's desire not to relocate. As a result, these takeovers frequently include moving the business from its home base, which is often a small community that can ill afford the move.

When a takeover occurs, the town loses not only the business but the outstanding community leadership provided by the management of that business. Often, vast charitable contributions from the business, family, or a family-established foundation are sacrificed when a takeover forces the relocation of a company. The combined effect of the loss of a well-rooted business, civic leadership, and charitable trust funds can and frequently does cripple and even kill a small town.

Charitable foundations are rooted in American history, particularly those created by a family-owned company in a small community. These families typically recognize an obligation to the communities which are the source of the families' wealth, and, therefore, establish foundations largely or solely by contributions of stock from the family businesses. These foundations—and these family-owned companies—generously support the educational, cultural, and social goals of the towns they serve.

The companies provide stability, through solid employment, to many towns that are hard hit by changing economic conditions in this country. The foundations finance many activities that would otherwise be neglected in a small community.

Additionally, the families who own these businesses and establish and support these foundations contribute in a vast way to the civic well-being of the community. These people are typically leaders in a number of cultural, social, educational, religious and civic events, ranging from church functions, scouting, civic pride activities, charitable fund drives, etc.

During this period of recession, the Administration has urged the private sector to provide support for a number of worthwhile, often critical, yet costly projects that the government can no longer afford.

Therefore, it would seem likely that our tax laws would encourage the formation of family foundations. On the contrary, our tax laws discriminate against and discourage these types of foundations.

Specifically, section 4943 of the tax code limits the stock holdings of a family foundation in a family business to such an extent that it sets up the company for a takeover.

This section prohibits the stock holdings of a private foundation and its "disqualified persons" from exceeding 20 percent of the voting stock of a company. The intent is to prevent foundations from serving as "holding companies" of large numbers of corporations. The effect is to create, in several ways, the substantial risk of a takeover of the company.

For example, gifts or bequests of stock are frequently made to a foundation in a community. If these stock transfers cause the combined holdings of the foundation and its disqualified persons to exceed the 20 percent limit, the foundation must divest itself of the excess stock within five years.

Anyone watching the fortunes of family businesses and who knows that a transfer has been made by gift of bequest to a foundation can determine that within a few years the foundation is going to have to dispose of stock of that company. This presents an opportunity to buy stock, possibly at "fire sale" prices, and obtain a significant position in a business enterprise. In fact, because of the necessity of the foundation to sell its stock, a sale of the entire interest of the family at the same time may be dictated in order to realize a fair price.

An even greater threat of a takeover arises out of a second situation created by section 4943. Holdings of a foundation as of May 26, 1969, are "grandfathered", in that they may continue to be held even if the combined foundation/disqualified persons' holdings exceed 20 percent. However, there is a ceiling on such holdings which is 50 percent in some cases and 35 percent in others.

Under a number of circumstances, however, the foundation may nevertheless be forced to sell its holdings until the combined holdings of family members and the foundation are not more than 20 percent.

For example, "disqualified persons" include second and third generation persons who are not involved in either the family business or the foundation. Outsiders interested in control of the company could assist any such distant disqualified persons to buy stock of the company and, therefore, force a sale of a like amount of stock by the foundation within 90 days. The effect would be to force a reduction in the combined holdings of the family and the foundation in order to maintain their mandatory limit of 20 percent or less of the company's outstanding stock. When others have so acquired blocks of stock, a foothold for takeover has been accomplished.

As an example of the way the definition of "disqualified persons" facilitates such a takeover, consider this actual case. During the 1940's "H" contributes to a family foundation. By definition, he is a "substantial contributor" and a "disqualified person" with respect to the foundation. By definition under the tax code, "W" ("H" 's wife) is also treated as having made the same contributions as "H" such that she is a substantial contributor, though she, in fact, made no actual contributions. "H" dies. Subsequently, "W" remarries "P", a widower. "P" is treated as a disqualified person because he is the spouse of a substantial contributor. The following are disqualified persons:

The lineal descendants from the marriage of "P" and "W".

The lineal descendants of "P" from his first marriage.

The lineal descendants of "H" and "W".

Spouses of all such lineal descendants.

It is obvious that not only do the children of "P" by his first marriage have no relationship whatsoever to the foundation and the business, but also it is likely that most of the lineal descendants previously described will have no loyalty to the business and the foundation. The clear effect is to create a group of "disqualified persons" who are not involved with the foundation, the business, or the community, but who have the power, through the purchase of stock in the business, to force the foundation to sell and make the business a takeover target.

The problem is not simply that of a foundation or of a family, but it pervades the quality of life of a community. The stability of a business and the charitable, education, and cultural advantages of a foundation greatly enhance the standard and quality of living in a small community. This is significant in attracting workers and executives to the community in which the business is located.

The key to stability of a business is the likelihood of continuity of management of the business. This is threatened by the provisions of section 4943 which operate to force the foundation to sell stock, throwing the control of the company up for grabs.

The takeover threat to local businesses is a serious problem, not just for the communities involved, but also for the system in this country which has fostered the development of family-owned businesses. One can read almost daily in the Wall Street Journal of a business seeking to protect itself against an acquisition by a conglomerate or other giant enterprise which seeks to expand by acquiring a business in another and sometimes unrelated field.

For example, during fiscal year 1982 there were 1204 pre-merger notification reports filed with the FTC and Justice's Antitrust Division pursuant to the Hart-Scott-Rodino Act. This figure represents an increase of approximately 11 percent over the previous year and of nearly 50 percent in the last four years. It should be noted, in this regard, that Hart-Scott-Rodino requires reporting of only the most significant mergers.

Needless to say, not all of these mergers are desired by or in the best interests of the acquired companies. Over the past year or so there appears to have been a substantial increase in the number of hostile tenders, and experience has shown that these tenders are very difficult to fend off without threatening the viability of the target company. It is certain that merger trends are accelerating.

W. T. Grimm & Co., which tracks merger announcements, reported that 1981 merger activity increased 27 percent to 2,395 transactions, compared with 1,889 a year earlier. Although friendly deals are still the dominant form, an increasing number of combinations are now the result of hostile actions. Most of the deals involve small companies.

Grimm reports that acquisitions of small privately held companies remain the focal point of mergers and acquisition activity. Of the 2,395 transactions tabulated for 1981, 1,332 or 56 percent involved the sale of a closely held firm. This figure actually represents an increase from 52 percent in 1980.

But what differentiates the present merger wave from prior waves is a set of market conditions which have encouraged large and established companies to engage in an unprecedented number of hostile acquisitions, according to Grimm. The data collected by Grimm in 1981 reflected the highest number of hostile tender offers that Grimm's research department has ever recorded.

In the current hostile atmosphere, few companies faced with an unsolicited tender offer survive as independent companies. Another recent trend suggests that it is the well-managed firms which are frequently the targets.

In my own state of Ohio, we had several examples in the past few years of large international corporations seeking the acquisition of local businesses. The impact in each case on the community was sufficient to cause considerable alarm as to the effect of such takeovers on jobs and other local interests. Members of the Congress were concerned as to the spectre which this raised for businesses in other parts of the country as well.

The tax laws should not purposely become a tool to force the sale of local businesses and adversely affect the quality of life in communities which have been well served by local family owned businesses and their foundations. I urge revisions in section 4943 to reduce the takeover threat it creates.

Thank you for the chance to testify on this serious problem. I appreciate your attention and concern.

Mr. PICKLE. Thank you, Mr. Regula. I thank all you gentlemen. You have covered a broad range of topics and approaches that are pertinent to the question at hand, and your comments will be helpful to this committee.

First I would ask any of you gentlemen if you would want to respond to any point that had been made by any of your colleagues?

Mr. STARK. Mr. Chairman.

Mr. PICKLE. Mr. Stark. I anticipated this.

Mr. STARK. No, no, I wanted to concur in Mr. Frenzel's remarks. In summarizing my statement, I did skip an important point: there are some foundations who, because of quirks in the law, are literally and legally unable to divest but are trying to do that as best they can. I would submit that the committee should look favorably on assisting a foundation that is attempting to comply with the law but may have an antitrust or another regulatory law that prohibits them from so doing.

Those people I think should be encouraged to continue attempting to comply. Those who are just saying no, exempt us from the law, I don't think should be given this treatment.

Mr. **Pickle**. Mr. Stark, I was impressed with your statement raising the question that we might be better served by a limited life for foundations with a greater payout over a shorter period of time.

Would you suggest that most of our foundations be given a limited life—say 5, 10, 15, 20 years, and then just fade out?

Mr. **Stark**. Mr. Chairman, that sounds like too short a time to me. I am thinking that in terms of the accomplishments of aiding medical research or aiding education or aiding a host of worthy causes that in the neighborhood of 30 to 50 years would be——

Mr. **Pickle**. If Congress decided on an appropriate period for a sunset, you would support such on approach?

Mr. **Stark**. Yes, rather than that——

Mr. **Pickle**. You say we ought to consider that approach.

Mr. **Stark**. Yes.

Mr. **Pickle**. Congress should set a time definite in which foundations would expire?

Mr. **Stark**. Yes, sir.

Mr. **Pickle**. I thank each one of you.

I think you raised good points on very significant and diverse subjects. It will be helpful to the committee.

This is the first time we have held hearings on foundations in 10 or 15 years and it is very, very valuable to us to have you here.

Mr. Shelby?

Mr. **Shelby**. I have no other comments, I just appreciate being able to be here.

Mr. **Pickle**. Thank you.

Mr. Duncan.

Mr. **Duncan**. Thank you, Mr. Chairman.

I want to thank our colleagues for their testimony. I think some of you touched on the problem concerning the acquisition of local newspapers. If they are forced to sell by the law, and the chain newspapers buy them up, that is something we ought to be interested in. We have seen that trend throughout the country, and especially in my home community they are owned by a large chain now and we have no real comity of community with those people.

Mr. Stark, you raised the question about limited life of foundations but do you think that people of wealth are as charitable as they were 25, 30, 40 years ago? If you lost a foundation, would another one be established as quickly to take its place? It seems to me that today so many people think that charity is the function of Government and the good samaritanship that we once knew isn't there. Just let the Government take over what the charities are doing today. Would you comment on that thought?

Mr. **Stark**. Mr. Duncan, I think that the encouragement of philanthropy is often done as much in the tax codes as it is through a good and generous heart. I think the issue of whether or not you should limit the life really doesn't deal with creating them. Let's assume a hypothetical case, a community where someone leaves a foundation, the purpose of which is to grant scholarships to certain children, and let's assume that it is a limited community and that community becomes an industrial community over a period of 30 or 40 years resulting in few children who qualify.

Sometimes we do find examples of the need for the restrictive type of gift disappearing because society changes. All I am suggesting, Mr. Duncan, is that it seems to me in a half century you ought to be able to perpetuate and incorporate and encourage ideals that you wish to foster in a foundation and the money ought to be distributed 50 years after. Fifty years after you and I are gone, who knows what the managers will do with the wishes we have? I think the donor or creator of a foundation would see his or her good works carried out in a better manner and using that money in a way the donor intended.

Mr. DUNCAN. Some of your best foundations today are those that are the oldest foundations.

Mr. STARK. I wonder if they really are carrying out the intention of the creator of the foundations? Would they not work if they were to distribute all of their money in the way they have and a new foundation come along to take its place?

Mr. DUNCAN. That is what we are doing in government.We are distributing all the money in 1 day and borrowing it the next.

Mr. STARK. I know, but you and I didn't vote for that.

Mr. DUNCAN. We are passing it all on to the younger people. Are there any other comments?

If not, thank you very much.

Mr. PICKLE. Mr. Thomas.

Mr. THOMAS. Thank you, Mr. Chairman.

Mr. Shelby, at least some of us think that possible exemptions might have merit. We hear a number of people testifying with specific sets of facts. I am sure if the folks back in 1969 had looked at them, they would have been amazed at the diversity that they were trying to deal with that set of principles.

Mr. Shannon and Mr. Frenzel, I agree with you since I cosponsored H.R. 3043. I look at your particular cases and they come along.

Mr. Regula, I have looked at the ratchet-down operation and I am trying to find the rationale for why they included it in the law in 1969. You can go on ad infinitum with hypotheticals similar to the actual case that you presented in your written testimony where no social purpose is served by requiring the ratchet-down in operation. We are going to continue to look at those particulars.

Mr. Stark, you mentioned 50 years. If we are going to have a limited life on foundations. Wright Patman talked about 25 in the 1960's; do you have any feelings in terms of that?

Mr. STARK. Mr. Thomas, I really don't. I just guess my idea is prompted by the fact that foundations become an entity unto themselves after a period of time. Foundations begin to recreate themselves in the minds of the trustees and not necessarily in the minds of the donors and they begin to build assets. I am not sure that we intended to create financial institutions, really big investment institutions, and only recently they came and begged us to lower the amount they could pay out to 5 percent, the law before 1981 is they had to pay out not less than 10 or all of their earnings. They want to grow.

That is a bureaucratic institutional tendency when you have a good operation going to continue it. I would urge this committee to study the idea of what might be a limit and as something as opposed to perpetuity. I have no preconceived ideas. If I had to pick a number today I would say somewhere in 30 to 50 years seems to be a good period of time to accomplish the objectives of well-meaning donors but someone might come up with evidence that it should be more or less.

Mr. **Thomas**. If the criteria used were the rationale of the donors for setting up the foundations, some of them would outlive their reason for creation within a decade or less, and some could go on for hundreds of years based upon the way in which the donor wanted the money distributed.

You appreciate the difficulty of trying——

Mr. **Stark**. Indeed I do.

Mr. **Thomas**. If we were to terminate foundations after a period of time you indicated that other foundations ought to take their place, that when they have outlived their usefulness new ones ought to spring up. You said we should do various things within the code to encourage formation of new foundations, in your written testimony. Do you have specific suggestions as to how you might want to change the code to encourage formation of new foundations beyond what we have in the code now?

Mr. **Stark**. I think there are plenty of incentives now in the code. I think Mr. Shannon has suggested some means by which the code can be amended to increase giving, but I think that if we went to the flat tax, which is so popular now, we would eliminate all deductions for charitable contributions. I think obviously something would have to be done to replace the charitable deduction if we were going to have what makes such good sense to so many people, the flat tax.

So I think as we go along now with our hodgepodge of deductions that charities have gotten their share. One of the incentives to be to raise the tax rates on individuals. That would make charitable deductions relatively attractive but I am not sure how many votes I could get in this subcommittee for that.

Mr. **Thomas**. I was just reacting to the statement in your testimony on page 3 that attention should be paid to assuring we encourage formation of new foundations to replace those that would expire over time. I would hope you have specific suggestions. I might take the idea for creation of new foundations and not pick up the termination part of it.

Thank you, Mr. Chairman.

Mr. **Pickle**. Thank you, Mr. Thomas.

Mr. Anthony.

Mr. **Anthony**. Thank you, Mr. Chairman.

I would like to ask Mr. Stark if he thinks the compensation section that you mentioned in your testimony is a severe problem, and if we should take a closer look into that?

Mr. **Stark**. I think the suggestion that you get a $1 million salary for serving as the executive officer of a foundation begins to touch on an area where it sounds to me that there may be excessive compensation. We might limit compensation to that of a Member of Congress as an example, give us a little help the next time we have to vote for our own pay raise. Other than that I think that there is a possibility there and I think the press raised some examples of issues where there may be excessive compensation.

You may get a bad apple that spoils the barrel but it behooves us to look into it for excessive expenses of all times, whether it is maintaining an executive jet aircraft or salaries or vacation homes for executives and trustees. It seems we ought to be sure that as much of this money as possible goes to charitable recipients and not to professional managers.

Mr. ANTHONY. After hearing your testimony, I was disturbed to learn that the compensation becomes part of the test for contributions.

Mr. STARK. I think it is conceivable, Mr. Anthony, that you could, under the 5-percent rule, you could distribute 5 percent of the income to all the trustees and executives and nothing, in effect, to charitable recipients and meet the test.

Mr. ANTHONY. But I don't think you could be consistent with our intentions if that occurred.

Mr. Regula, I noticed in your testimony that contrary to some of your colleagues at the table, they had specific companies or foundations in mind.

Do you have a specific company or foundation in your State or district in mind, or is this a general statement that you're making for the record?

Mr. REGULA. We have several foundations and we have had some attempted takeovers in my district, but basically I would want to address the problem as a national policy issue and hope the subcommittee would look at the impact the takeover law has on the whole situation because of definitions like disqualified persons.

I was really addressing the general problem. However, it could impact on any community as well as the one I represent, because of the fact that we have a number of companies that are basically home based in the 16th District, that are well managed and are potential candidates always for takeovers, and that also have foundations.

Under the requirements of the law, you have to determine, as I have outlined in a hypothetical case here, what are disqualified persons, and it does give a tilt in the scales in favor of takeover. I think that is a serious problem as we look down the road because of the debilitating impact of taking out of the community that pool of leadership that is so valuable in all of our communities.

So it is not really addressed to a specific instance.

Mr. ANTHONY. There is another area that I think your statements indirectly touched on; that of the fiduciary responsibility of the trustees or boards of these foundations. If they are compelled under the 1969 act to divest and at the same time they have a fiduciary responsibility to get the highest and best return on their capital, then you could set up a situation where they obey the law and at the same time set themselves up for a class action for not doing the best for the foundation.

Mr. **Regula**. I mention in there they might get into a fire sale or distress situation, and that is another possibility.

I just commend the subcommittee for looking at the totality of the problem. I suspect in 1969 there was an attempt to address some glaring "abuses," and as always is the case, you take that broad blush and in the process perhaps do some or create some situations where there can be an injustice or certainly a situation that is not in the best interests of social and national policy.

Mr. **Anthony**. I yield the balance of my time, Mr. Chairman.

Mr. **Pickle**. Again, the Chair wants to thank each one of you for your testimony. You have really highlighted the key facts we will have to consider as we proceed in consideration of these issues. We thank each one of you gentlemen.

The next witness is Mr. John Finch, an Associate Director of the U.S. General Accounting Office.

Mr. Finch, would you come forward, please?

Mr. Finch, please identify your entourage.

Mr. **Finch**. Yes, sir, Mr. Chairman, I will do that.

Good morning, Mr. Chairman.

Mr. **Pickle**. Good morning.

Mr. **Finch**. If I might introduce my colleagues, to my right is Dan Harris. Dan is the Group Director in charge of all the work we do in the tax area in GAO.

To my left is Tom Richards. Tom was the audit manager on this particular effort which produced the testimony that I am about to give.

Mr. **Pickle**. We are pleased to have all of you gentlemen here. If you will proceed, Mr. Finch, we will be pleased to hear your testimony.

STATEMENT OF JOHNNY C. FINCH, ASSOCIATE DIRECTOR, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY DANIEL HARRIS, GROUP DIRECTOR, AND THOMAS RICHARDS, AUDIT MANAGER

Mr. **Finch**. We have a rather detailed and lengthy statement, Mr. Chairman, and with your permission, we will submit that for the record. And in accordance with your request, I will try to summarize it in about 5 minutes.

Mr. **Pickle**. That would be granted and appreciated, because you have an encyclopedia here.

Mr. **Finch**. There are a number of pages there, yes, sir.

Mr. Chairman, members of the subcommittee, we are pleased to have the opportunity to assist your subcommittee in carrying out its oversight of private foundation operations and activities.

In 1969, the Congress enacted a series of rules aimed at insuring that only those private foundations operating for the public benefit enjoy favorable tax treatment.

The primary purpose of my testimony is to draw a statistical profile of the private foundation community in terms of certain economic characteristics which illustrate how foundations are operating under those rules.

Specifically, as requested by the subcommittee, we analyzed foundation return information to determine the financial well-being of private foundations, and the degree to which private foundations use their financial resources for charitable purposes.

Our analysis of available data—primarily an IRS sample of private foundation returns for tax year 1979—indicates that the number of private foundations have increased from 14,865 in 1962 to 31,866 in 1981—a 114 percent growth. Their assets at market value have increased, over the same period, from about $16.3 billion to about $51 billion—a 213 percent increase. Their total annual receipts also increased from about $1.9 billion to about $9.1 billion—a 379 percent increase.

Concurrently, foundations' total annual expenses increased from about $2.7 billion in 1974, the earliest year for which data was available, to about $4.8 billion in 1981—a 78 percent increase.

Likewise, those expenses related to exempt purposes increased from about $1 billion in 1962 to about $3.2 billion in 1979, the most recent year for which data was available—a 220 percent increase.

Notwithstanding those increases, the data also indicates that foundations, on a percentage basis, are spending less of each year's receipts. For example, in 1974 foundations spent about 97 percent of their total receipts, as compared to about 53 percent in 1981.

Similarly, the percentage of total receipts disbursed for exempt purposes has also decreased—from about 86 percent in 1974 to about 54 percent in 1979.

As I previously mentioned, private foundation financial growth appears substantial when measured in actual dollars. However, an examination of available financial data in terms of constant dollars shows a less dramatic picture—a 13 percent increase; and, in fact, over the last 2 years, asset values declined about 5 percent. Even so, our analysis of available data showed that private foundations have earned and/or received sizable revenues and have annually retained more and more of these revenues.

Earnings on assets, particularly as measured by adjusted net income, is particularly important to the financial well being of foundations and their ability to continually fund charitable activities. In this regard, our analysis of return data for 1979 showed that foundation adjusted net income, expressed as a percentage of assets, was generally below 1979 inflation rates, which ranged between 8 and 13 percent depending on the measure used.

The limited financial growth of private foundation assets since 1962, as measured in constant dollars, may in part be attributable to inflation and to the charitable purpose distribution provisions of the 1969 Tax Reform Act which required most foundations to make certain qualifying distributions for charitable purposes in an amount essentially equalling all earnings on their assets. This provision was changed effective in January 1982. Another reason for the decline in the real value of foundation assets lies with the nature of those assets. In fact, our analysis showed that foundations have extensive holdings in the stock of for-profit businesses. Given this, the depressed stock market conditions that existed until recently may help explain the declining trend in the real value of foundations' assets over the last few years.

Foundation investment and earnings practices are only one side of a foundation's economic profile. The degree to which private foundations direct their resources to serve charitable purposes, is equally as important.

In this regard, our analysis showed that of the $3.5 billion of total expenses incurred by foundations in tax year 1979, about $3.2 billion, or about 91 percent, were reported as disbursements for charitable purposes. However, only about two-thirds of all foundations reported charitable purpose disbursements at about the 91 percent level or greater. Furthermore, some reported disbursing very little for charitable purposes in comparison with their total expenses. Similarly, about 72 percent of all foundations reported charitable purpose disbursements equalling at least 90 percent of their adjusted net income and some reported disbursing little even though their adjusted net income was quite large.

Mr. Chairman, the foregoing information briefly summarizes the financial results of foundation operations—primarily for tax year 1979—under the rules which Congress enacted in 1969 to govern foundations. Those rules were enacted to assure that private foundations serve public rather than private interests. Our statistical analyses of the financial aspects of foundation operations, standing alone, do not permit us to reach hard and fast conclusions as to whether foundations are properly balancing their operations between serving the public and meeting their own financial needs and whether there is a need for more or less regulations. What the proper balance should be, can best be determined through the legislative process and public debate, as represented by hearings such as these. We trust that the information we have presented today will assist the subcommittee and the Congress in making these determinations.

I would like to turn briefly to a related matter—the Internal Revenue Code provisions requiring foundations to make extensive public disclosures on their returns. With reductions in Federal spending, many people will look to tax exempt private foundations for aid and the need for complete and accurate public reporting by foundations will become even more important.

In view of this, we recently evaluated how well IRS assures that private foundations comply with the reporting requirements of the Internal Revenue Code.

In summary, we found that private foundations generally comply well with those reporting requirements which IRS, through its actions, has identified as being necessary for tax computation and enforcement purposes.

Most foundations, however, did not comply as well with other statutorily required information that is useful to the public: information on grants, investments, and foundation management. This is because IRS has devoted less attention to enforcing those requirements.

To assure that the Congress and the public's information needs for oversight and grant seeking purposes are met, we recommended that IRS make certain administrative changes to better enforce those tax exemption reporting requirements.

IRS agreed with our recommendations and is taking actions to strengthen its enforcement program and improve its management information system.

This concludes my statement, Mr. Chairman. I would be pleased to respond to any questions.

Mr. PICKLE. Thank you very much, Mr. Finch.

[The prepared statement follows:]

STATEMENT OF JOHNNY C. FINCH, ASSOCIATE DIRECTOR, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Mr. Chairman and members of the Subcommittee:

We are pleased to have the opportunity to assist your Subcommittee in carrying out its oversight of private foundation operations and activities. In 1969, the Congress enacted a series of rules aimed at ensuring that only those private foundations operating for the public benefit enjoy favorable tax treatment. Today, your Subcommittee wants to know how well those rules are working.

Towards this end, the primary purpose of my testimony is to draw a statistical profile of the private foundation community in terms of certain economic characteristics which illustrate how foundations are operating under those rules. And, I also want to share with the Subcommittee some of our observations regarding foundation practices in reporting statistical and other information needed for congressional, public, and IRS oversight.

Specifically, as requested by the Subcommittee, we analyzed foundation return information to determine:

--the financial well-being of private foundations, as indicated by the rate of growth in their financial resources over the years, their major sources of revenues, the extent of their business holdings, and rate of return on their investments and business operations; and

- the degree to which private foundations use their financial resources for charitable purposes, as evidenced by the type of expenses they incur and the relationship between their expenditures for charitable purposes and their total expenses, as well as their earnings.

To develop information on the foundations' financial resources and charity-related expenditures, we analyzed an available IRS computer data base containing a sample of returns filed by private foundations for tax year 1979.[1] To supplement the data on foundation business holdings, we also analyzed microfiche records of the most recent returns available as of December 1982--primarily tax year 1981 returns--for private foundations reporting assets of $1 million or more. While our work involved extensive analysis of return information, I would like to emphasize that, as agreed with the Subcommittee, we did not examine the books and records of foundations or discuss our analyses with foundation managers or their representatives.

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[1] This data base was the most recent and complete source of computerized data on private foundations available to us for analysis within the timeframes for this hearing. The data base was developed by IRS' Statistics of Income Division based on a sample of private foundation returns processed by IRS during 1980. The sample was stratified based on size of total foundation assets and selected at rates that ranged from 7 percent of foundations with assets of less than $25,000 to 100 percent of foundations with assets of $10 million or over. There were 9,438 returns in the sample drawn from an estimated population of 29,845 private foundations. While we did not review IRS' methodology in detail, we did look briefly at the procedures IRS followed to sample, process, and analyze the data and found them to be generally sound. We also performed limited checks on the data to assess its reliability. It should be recognized, however, that any data analysis effort which is based on a sample is subject to a certain amount of sampling error. The size of this error generally depends on the size of the sample and how much the data varies for any given element. Our limited analysis shows that even though IRS' sample sizes are relatively large, the data varies considerably. Therefore, the figures presented should not be considered precise, but rather as indicators of the foundations' financial positions. On the other hand, because the sample size increased as book value of assets increased, greater reliability can be placed on the data for the larger foundations.

Given the importance of accurate and complete information to the oversight of foundation operations and the grant-seeking process, I would also like, as part of my testimony, to address the reporting practices of private foundations. We recently completed a review of IRS' administration of foundation reporting requirements imposed under the Internal Revenue Code; and our report will be issued shortly. As I will discuss in more detail later, we concluded from our review that IRS needs to do more to assure that private foundations fully comply with all information reporting requirements. IRS has agreed with our recommendations and has begun to implement them. This should help to assure that more complete information is available for both oversight and grant-seeking purposes.

OVERALL PROFILE OF PRIVATE FOUNDATION FINANCIAL PESOURCES AND EXPENDITURES

Private foundations are unique charitable tax-exempt organizations. Unlike other types of exempt organizations, they are frequently founded, financially supported, and operationally controlled by an individual, family, or other closely controlled entity. Like other types of charitable tax-exempt organizations, however, they are required to permanently dedicate their assets to public purposes, as opposed to serving the private financial interests of the controlling parties.

In general, private foundations serve public purposes in two ways. First, some make grants to other tax-exempt charitable organizations, such as schools, hospitals, and community organizations, so that these organizations can provide needed public services. Second, some directly carry out charitable activities, such as operating museums, performing research, or assisting in community development. With reductions in federal spending, such as Federal aid to education, health and social welfare, many people are looking to private foundations to help fill the funding gap.

The close control private individuals frequently maintain over foundation assets and operations has, over the years, given rise to congressional and public concern over how well foundations are living up to their mandate of serving public interests. Because of this concern, the Congress, as part of the Tax Reform Act of 1969, enacted a series of rules governing the activities and operations of private foundations. For example, the Internal Revenue Code contains minimum payout provisions that foundations must comply with in determining how much to spend on charitable activities. Similarly, the Code imposes requirements governing foundation business and investment practices, such as restrictions on self-dealing, business holdings, and jeopardy investments. Within these rules, foundations must decide how much of their revenues should be spent to carry out the charitable purposes of the organization and how much should be retained and invested to sustain the organization so that it may continue to provide charitable services in the future years.

In this regard, our analysis of available data indicates that the number of private foundations have increased from 14,865 in 1962 to 31,866 in 1981--a 114 percent growth. Their assets at market value have increased, over the same period, from about $16.3 billion to about $51 billion--a 213 percent increase. Their total annual receipts also increased from about $1.9 billion to about $9.1 billion--a 379 percent increase. Concurrently, their total annual expenses increased from about $2.7 billion in 1974, the earliest year for which data was available, to about $4.8 billion in 1981--a 78 percent increase. Likewise, those expenses related to exempt purposes increased from about $1 billion in 1962 to about $3.2 billion in 1979, the most recent year for which data was available--a 220 percent increase.

Notwithstanding these increases, the data also indicates that foundations, on a percentage basis, are spending less of each year's receipts. For example, in 1974 foundations spent about 97 percent of their total receipts, as compared to about 53 percent in 1981. Similarly, the percentage of total receipts spent for exempt purposes has also decreased--from about 86 percent in 1974 to about 54 percent in 1979.

While the data indicates that foundations are retaining more of their receipts each year, this does not necessarily mean that the foundation community is not complying with the minimum payout provisions of the Internal Revenue Code. From 1969 through 1981, the minimum payout provisions were keyed to adjusted net income which, as defined by the Code, excluded both donations received and long term capital gains realized. As I will discuss later, our analysis of 1979 return information shows that, in the aggregate, the receipts retained by private foundations roughly approximated the amount of donations they received.

I would now like to discuss the statistical analyses we did to profile the financial well being of private foundations and then discuss the degree to which private foundations use their financial resources for charitable purposes.

THE FINANCIAL WELL BEING AND RESOURCES OF FOUNDATIONS

To carry out their charitable activities, private foundations need to have a sound financial resource base. These resources have traditionally come from donations received by the foundations, as well as earnings on investments.

As I previously discussed, the market value of foundation assets, expressed in actual dollars, increased substantially over the period 1962 through 1981. When expressed in constant dollars, however, the percentage of growth is not as substantial. In fact, over the last few years, asset values declined sightly. Even so, our analysis of available data showed that private foundations have earned and/or received sizable revenues and have in recent years retained an increasing part of these revenues.

Investments make up a large and important part of private foundations' financial resources. In fact, our analysis showed that foundations have extensive holdings in the stock of for-profit businesses. Given this, the depressed stock market conditions that existed until recently may help explain the declining trend in the real value of foundations' assets over the last few years.

Earnings on assets, particularly as measured by adjusted net income, are also important to the financial well being of foundations and their ability to continually fund charitable activities. In this regard, our analysis of return data for 1979 showed that foundation adjusted net income, expressed as a percentage of foundation assets, was generally below 1979 inflation rates, which ranged between 8 and 13 percent depending on the measure used. This situation may help explain why private foundation disbursements for charitable purposes--expressed in constant dollars--did not increase significantly over 1974 levels. We also noted that, in general, foundations which had a more balanced mix of investments in corporate stocks and bonds and in cash investments and U.S. Government obligations had higher rates of return than foundations which had more concentrated corporate investments or other investments. Also, larger foundations generally earned a slightly higher rate of return than smaller foundations.

Extent of private foundation asset growth

It is difficult to determine long-term trends in private foundation growth for two reasons. First, data relating to private foundations has not been consistently or continuously kept over the years. Second, changes in the tax exemption laws make comparisons imprecise. Within these limitations, however, IRS' Statistics of Income Division published three studies on private foundations which covered selected years between 1962 and 1979. Attachment I to my statement contains selected data from these studies, as well as other data which we developed for

1980 and 1981 based on information available from IRS' master file.

As shown in attachment I and as previously discussed, private foundation financial growth appears substantial when measured in actual dollars. However, an examination of the financial data in terms of constant dollars shows a less dramatic picture. To obtain estimates in terms of constant dollars, we applied the Gross National Product Implicit Price Deflator to the current dollar data. Based on these estimates, foundation assets, at fair market value, increased from about $23 billion to $26.1 billion over the 19-year period--a 13 percent increase. Over the last two years, however, these assets have shown about a 5 percent decline. Similarly, for the period 1962 to 1979, foundation disbursements for exempt purposes, in constant dollars, increased from about $1.4 billion to about $2.0 billion--a 43 percent increase. However, since 1974, these disbursements also showed a 5 percent decline. On an annualized basis this represents about a .7 percent compounded growth rate for assets over the 19-year period and about a 1.9 percent compounded growth rate for charitable disbursements over the 17-year period.

The limited financial growth of private foundation assets since 1962, as measured in constant dollars, may in part be attributable to inflation and to the charitable purpose distribution provisions of the 1969 Tax Reform Act. Those provisions required most foundations, during the period 1969 through 1981 to make certain qualifying distributions for charitable purposes in an amount essentially equalling all earnings on their assets. Thus, foundations could not invest part of their adjusted net income to counteract the detrimental effects of inflation. However, recent legislation which changed this requirement should improve the financial growth pattern of private foundations.[2] In general, most foundations are now required to make charitable distributions in an amount equal to 5 percent of their investment assets.

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[2] The Tax Reform Act of 1969 generally required foundations to make certain charitable or other exempt purpose distributions in an amount at least equal to the greater of their adjusted net income or a specified percentage--subsequently fixed at 5 percent--of the value of their investment assets, less certain taxes and adjustments. The Economic Recovery Tax Act of 1981 repealed the adjusted net income requirement on the basis that the rate of return that assets generally earn represents a real income portion and a portion to compensate for the effects of inflation. As a result, the effect of requiring foundations to pay out all adjusted net income in qualifying distributions was to gradually reduce the real value of private foundation investment assets.

Another reason for the decline in the real value of foundation assets lies with the nature of those assets. Foundations have extensive holdings in corporate stocks. In fact, our review of the most recent foundation returns shows that some foundations have most of their assets invested in a single company. Until recently, of course, stock market prices have been depressed and this has been reflected in the fair market value of foundation assets. With the current advancement of stock prices, the fair market value of their assets should increase.

Foundation revenues have exceeded expenses

Even though foundations have shown limited growth in terms of constant dollars over the years, our analysis showed that they have earned and/or received substantial revenues and have retained more and more of them. For example, in 1974 private foundation revenues exceeded total expenses by $75 million. This surplus amounted to about 3 percent of total revenues. In comparison, the surplus in 1979 amounted to about $2.5 billion or about 41 percent of foundation revenues and in 1981 grew to $4.3 billion or about 47 percent of foundation revenues.

To determine the sources of foundations' revenues, as well as the number of foundations whose revenues exceed expenses and the primary source of those revenues, we compiled a summary income statement using financial data available from IRS' sample of private foundation returns for tax year 1979.

As shown in attachment II, in tax year 1979 foundations reported revenues totaling about $6 billion. The largest source of these revenues--passive income, such as dividends, interest, rents, and royalties--accounted for about $2.6 billion. The second largest source--donations--accounted for about $2.3 billion. The third largest source of revenues--the net gain from asset sales--accounted for about $.8 billion of $1.1 billion in other income. In addition, foundations reported $50 million in income from unrelated business activities.

The attachment also shows that foundations reported spending about $3.5 billion, or about 58 percent, of their $6 billion in total revenues. About 55 percent of all foundations reported revenues exceeding expenses, 6 percent reported revenues equaling expenses, and about 39 percent reported deficits.

In general, our analysis showed that larger foundations were more likely to have revenues exceeding expenses than smaller foundations. In the aggregate, the excess of foundation revenues over expenses, at least in 1979, roughly approximated the amount of donations received by private foundations. However, for the largest foundations analyzed--those with assets exceeding $10 million--the excess of revenues over expenses exceeded donations received while smaller foundations actually used some of the donations to fund their activities. In fact, when comparing the revenues and expenses of various size foundations, we noted that foundations' reliance on donations to fund their activities increased as the size of the foundation decreased.

Foundation investments

Foundations hold a vast amount of financial resources to support their charitable activities. The use to which these resources are put has long been a concern of various congressional committees. This concern led to the enactment of section 4943 of the Internal Revenue Code which limits the extent to which foundations can own for-profit businesses.4/ Currently, several bills are pending before the Congress to amend this provision.

4/Generally, under section 4943, a foundation and all disqualified persons, such as the foundations' officers, directors, substantial contributors, and certain of their relatives, may not own together more than a 20 percent interest in a business. This section also provides a series of transitional rules for foundations which held stock on May 26, 1969. These transitional rules prescribe time periods for foundations to divest their excess holdings based on the extent of their holdings in 1969. One such divestiture period ends on May 26, 1984.

To assist this Subcommittee in reviewing the investment practices of private foundations and evaluating how foundations have operated under section 4943, we developed detailed information on foundation investments from two sources.

First, our analysis of IRS' data base of a sample of 1979 foundation returns showed that foundations hold substantial investments in stock of for-profit businesses. As shown in attachment III, about one-half of all foundations in 1979 reported holding corporate stock amounting to about $15.7 billion at book value. The larger foundations were more likely to hold corporate stocks. For example, 88 percent of foundations with assets exceeding $10 million at book value held corporate stocks amounting to about 50 percent of their total assets. In comparison, about 50 percent of the foundations with assets ranging from $25,000 to $100,000 held corporate stocks amounting to about 31 percent of their assets.

Second, to obtain further information on foundation stock holdings, we reviewed microfiche copies of the most recent foundation returns available as of December 1982--primarily tax year 1981--which reported assets in excess of $1 million. Of the 3,851 returns reviewed, 365, or 9 percent, reported owning 2 percent or more interest in a for-profit business. We used the

2 percent figure because of the de minimis rule on excess business holdings, as specified by section 4943 of the Code.[5] Although IRS does not require foundations to report any further information on the nature or extent of these holdings, they are required to report the identity, market, and book values of all stock held. Attachment IV is a listing of these 365 foundations, their two largest stock holdings, and the extent to which these holdings account for the total fair market value of the foundation's assets.

As shown by attachment V, the largest stock holding of these 365 foundations, in the aggregate, amounted to about $8.3 billion or about 43 percent of their total assets. To place this in better perspective, the $8.3 billion represented about 16 percent of the $51 billion in total assets--at fair market value--held by the 31,866 private foundations recorded on IRS' master file for tax year 1981.

Also, as shown by this attachment, many of the 365 foundations had a substantial portion of their total assets in the stock of a single business. For example,

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[5] In general, the excess business holdings provisions of section 4943 only apply if a foundation owns at least 2 percent of the voting stock and at least 2 percent of the value of all outstanding shares of all classes of stock, regardless of the ownership by disqualified persons.

--116 foundations held corporate stock of a single business amounting to 50 percent or more of the fair market value of each foundation's total assets. This stock, in the aggregate, was valued at about $7 billion.

--27 foundations held corporate stock of a single business amounting to 95 percent or more of the fair market value of each foundation's total assets. In the aggregate, this stock was valued at $1.5 billion.

Furthermore, 14 foundations each had a largest holding worth $100 million or more. In the aggregate, this totaled $4.5 billion or 23 percent of the 365 foundations' total assets.

While many foundations have a substantial portion of their assets in a single stock holding, this does not necessarily mean that these foundations will have excess business holdings as defined by section 4943 of the Code. To determine if a foundation has business holdings which may, in the future, constitute an excess holding, other information is needed. This includes,

--percentage interest of the business owned by the foundation,

--percentage interest of the business owned by all disqualified persons,

--classes of stock held by the foundation and disqualified persons, and

--dates the interests were acquired.

Since private foundations are not required to report this information on their returns, we were unable to determine whether any of the foundations' largest holdings may, in the future, be an excess business holding.

Foundation earnings

In order to continually fund charitable activities beyond the level of donations they may receive, private foundations must invest some financial resources to earn a reasonable rate of return. One measure of a private foundation's financial ability to make charitable distributions is adjusted net income. Generally speaking, adjusted net income, as defined by section 4942(f) of the Internal Revenue Code, is the amount by which a private foundation's revenue exceeds the expense of earning that revenue.6/ During 1979, the Code essentially

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6/In general, on the revenue side, adjusted net income includes all amounts derived from, or connected with, property held by the foundation, such as income attributable to amounts set aside, income from all exempt functions, and income from any unrelated trade or business activity. Deductible expenses are those foundation operating expenses which are paid or incurred to produce or collect those revenues. However, expenses associated with property used for exempt purposes which exceed the revenues derived from that property are not allowed as a deduction. Rather, the expenses would be accounted for as a disbursement for charitable purposes. Also, by definition, adjusted net income does not include long-term capital gains or losses nor gifts, grants, or contributions received by the foundation.

required most foundations to make certain charitable distributions in an amount at least equal to their adjusted net income.

To measure the return foundations earned on their assets, we analyzed their adjusted net income first as a percentage of the fair market value of their total assets and, second, as a percentage of the book value of their total assets excluding those assets identified on the balance sheet sections of their returns as being held for directly carrying out charitable purposes. We did this analysis using the information available from IRS' sample of foundation returns for tax year 1979.

As shown in attachments VI and VII, 45 percent of all foundations earned adjusted net income at a 5 to 8 percent rate when measured against either fair market value of total assets or book value of assets, excluding those being held for directly carrying out charitable purposes. Also, using the same measures, about 20 percent earned adjusted net income at a 0 to 1 percent rate. While the frequency of this 0 to 1 percent return rate was substantially influenced by the earnings of small foundations, some large foundations also had a similar return rate. For example, about 4 percent of the 2,930 private foundations with $1 million to $10 million book value of assets and about 6 percent of the 483 foundations with assets valued at

$10 million or more earned adjusted net income at a rate of 1 percent or less.

During 1979 most foundations' earnings rates, as calculated from return information, were below inflation rates.[7] Since, as I previously discussed, foundation asset values have not appreciated significantly in terms of constant dollars, earnings rates lower than inflation would lessen the ability of private foundations to make progressively larger charitable purpose distributions, at least in terms of constant dollars. Considering earnings from this perspective helps to explain why foundations' disbursements for charitable purposes--as measured in constant dollars--has shown a 5 percent decline from 1974 levels, as shown in attachment I.

Factors affecting foundation earnings

Given the range of private foundation earnings rates that I just discussed, and the importance of those earnings rates to the support of charitable activities, we wanted to determine if differences in the types of assets held by private foundations affected the rate of return earned. Accordingly, using IRS' sample of 1979 returns we compared the types of assets held by foundations--excluding assets reported as being held to directly carry out charitable activities--with the rates of return earned by foundations with those assets. In addition, since larger foundations would be more likely to employ professional investment advisors, we also considered foundation size in performing our analysis.

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[7] The inflation rate for 1979 as measured by the Consumer Price Index, Producer Price Index, and GNP deflator (fourth quarter 1979 over fourth quarter 1978) was 12.9 percent, 12.7 percent, and 8.0 percent, respectively.

To summarize the results of our analysis, I would first like to discuss how foundation size relates to earnings return. Attachment VI, which summarizes the rates of return earned by various size foundations, shows somewhat of a mixed picture, with larger foundations generally earning a slightly higher rate of return than smaller foundations. For example, 22 percent of the foundations with assets of $10 million or more earned a higher rate of return than the 5 to 8 percent return earned by most foundations. In comparison, 19 percent of the foundations with assets of from $25,000 to $100,000 earned more than the 5 to 8 percent rate of return. Further, in comparing these same two size categories of foundations, only 13 percent of the larger foundations earned less than the 5 to 8 percent rate while 28 percent of the smaller foundations earned less. Likewise, within the 5 to 8 percent range, 40 percent of the larger foundations earned a 7 to 8 percent return while only 28 percent of the smaller foundations earned a 7 to 8 percent return.

Similarly, the types of assets held also affected the rate of return. In general, as shown by attachment VIII, foundations with a more balanced mix of cash investments and U.S. Government obligations, and corporate stocks and bonds earned a better return than foundations with greater proportional holdings of corporate stocks and bonds and lesser proportional holdings of cash investments and U.S. Government obligations. Further, those with the greatest proportional holdings of "other" investments or assets (the IRS data base does not further identify these) generally earned the lowest rate of return.

For example, we compared the kinds of assets held by foundations earning 5 to 8 percent (the rate of return earned by most foundations) with foundations earning a 19 percent return or more (the highest return rate analyzed) and with those earning a 0 percent return (the lowest return rate analyzed). As shown by the attachment

--Foundations earning 19 percent or more had proportionately more cash and U.S. Government obligation investments than the 5 to 8 percent earners or the 0 percent earners--26 percent versus 17 percent and 9 percent, respectively.

--Foundations earning 19 percent or more had proportionately fewer assets in the category "other" investments or "other" assets than the 5 to 8 percent earners or 0 percent earners--8 percent versus 9 percent and 19 percent, respectively.

--Foundations earning 19 percent or more had proportionately fewer corporate stocks and bonds than the 5 to 8 percent earners; but so did the 0 percent earners--58 percent versus 71 percent and 62 percent, respectively.

Also, as shown in attachments IX through XIII to my prepared statement, these observations generally hold true for the various size foundations included in our analysis.

Our observations, however, must be qualified. The data base we analyzed did not contain data on (1) the rate of return on investments over several years, (2) the degree foundations' investment strategy complemented their charitable goals, or (3) the degree of risk assumed by foundations to earn the rate of return. Further, our analysis did not account for foundation earnings from long term capital gains because that source of income is excluded by law from the definition of adjusted net income. In addition, foundations could earn a very high rate of return without, for example, having a balanced mix of assets. A foundation could invest essentially all of its resources in corporate stocks paying high dividends in relationship to the acquisition price and have essentially no investments in interest bearing cash deposits or U.S. Government obligations. Moreover, the rate of return can be substantially affected by changes in market conditions which can occur frequently. Thus, to reach a final judgment as to the merits of an individual foundation's investment strategy requires information not available on foundation returns.

CHARITABLE AND OTHER EXPENDITURES OF FOUNDATIONS

Foundation investment and earnings practices are only one side of a foundation's economic profile. The other side involves how foundations spend their financial resources. I would now like to discuss the statistical analyses we did to profile the financial expenditures of private foundations, particularly as they relate to charitable endeavors.

Foundations are recognized as exempt from Federal income tax because of their charitable purposes. To determine the degree to which private foundations direct their resources to serve charitable purposes, we analyzed IRS' sample of foundation returns filed for tax year 1979 to ascertain the type of expenses foundations incurred and the proportion of these expenses that were for charitable purposes. We then analyzed the relationship of charitable expenses to adjusted net income to determine the degree to which foundations applied their income to support charitable purposes.

In general, our analysis showed that of the $3.5 billion of total expenses incurred by foundations, about $3.2 billion or about 91 percent were reported as disbursements for charitable purposes. The $3.2 billion of charitable purpose disbursements included $2.8 billion in contributions made to others and $.4 billion of expenses associated with making the contributions or delivering other charitable services. To better put these exempt purpose disbursements in perspective with the available foundation financial resources, which I have previously discussed, the $3.2 billion represents about 7 percent of total foundation assets at fair market value, about 54 percent of total foundation revenues and about 123 percent of foundation adjusted net income.

Although, on an overall basis, about 91 percent of total foundation expenses were reported as disbursements for charitable purposes, only about two-thirds of all foundations reported charitable purpose disbursements at about that level or greater. Furthermore, some reported disbursing very little for charitable purposes in comparison with their total expenses. Similarly, about 72 percent of all foundations reported charitable purpose disbursements equalling at least 90 percent of their adjusted net income and some reported disbursing little even though their adjusted net income was quite large. The following sections of my testimony provide the details of our analysis and also explain how a foundation on the one hand can report little in the way of charitable expenses yet on the other hand be applying essentially all of its resources to charitable purposes.

Extent of foundation charitable expenses

To profile the degree to which private foundations direct their resources to serve charitable purposes, we analyzed their expenses to determine the type incurred and the extent to which these expenses were reported as disbursements for charitable purposes. We also performed similar analyses for a broader measure of foundation charitable activities--qualifying distributions.

Private foundations, as shown at attachment XIV, incurred expenses totaling about $3.5 billion during tax year 1979. Of this total, foundations reported disbursing about $3.2 billion (91 percent) for charitable purposes. Charitable disbursements are defined by IRS to include gifts, grants, and contributions made to public charities and all necessary and reasonable administrative expenses paid by the foundation for religious, charitable, scientific, literary, educational, or other public purposes. In general, the remaining $.3 billion was spent to produce income--including revenues earned while delivering charitable services--or to conduct other activities to sustain the foundation.[8]

We analyzed the $3.5 billion of total expenses to identify the types of expenses incurred and the extent to which those expenses were reported as part of the $3.2 billion in exempt purpose disbursements or the $.3 billion in expenses for other operations. In summary, as shown by the attachment

--About $2.8 billion (about 79 percent of total expenses) was given as contributions to others to carry out charitable purposes. About 81 percent of all foundations reported making these charitable purpose contributions.

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[8] The data base analyzed contained detailed information on categories of total foundation expenses and the portion of these expenses allocated by the foundations as disbursements for charitable purposes. IRS requires foundations to report disbursements for charitable purposes on a cash basis and to report total expense data as recorded in the foundations' books and records. However, IRS does not require disclosure of accounting principles used for reporting total expenses or the basis for allocations to disbursements for charitable purposes. Furthermore, foundations incurring expenses while engaging in charitable activities which produce revenues are instructed to report these expenses as charitable purpose disbursements only to the extent the expenses exceed the revenues earned.

--About $269 million (about 8 percent of total expenses) was spent compensating officers, directors, and other employees, of which about $72 million (about 2 percent of total expenses) was attributable to officers and directors compensation. Overall, about $220 million, or about 82 percent of all compensation was reported as disbursed for charitable purposes. However, only about 9 percent of all foundations reported compensating their employees and only 19 percent reported compensating their officers and directors.

--About $89 million (about 3 percent of total expenses) was spent paying taxes, of which about $13.7 million or about 15 percent was reported as disbursed for charitable purposes. These amounts were probably paid to state and local governments, although the returns did not specify the nature of these payments. About 72 percent of all foundations reported paying taxes, and 18 percent reported some of these taxes as charitable disbursements.

--About $81 million (about 2 percent of total expenses) was spent on outside professional services, such as accounting, legal, and investment services, of which about $30 million or about 37 percent was reported as disbursed for charitable purposes. About 47 percent of all foundations reported paying for outside professional services and 28 percent reported some of these services as charitable disbursements.

--About $235 million (about 7 percent of total expenses) was spent on "other" expenses of which about $181 million or about 77 percent was reported as disbursed for charitable purposes. About 77 percent of all foundations reported "other" expenses and about 49 percent reported some of these "other" expenses as charitable disbursements. Further details on these expenses were not available from the data base analyzed.

In addition, some foundations reported relatively small amounts of interest, depreciation, and rental expenses.

Although in the aggregate about 91 percent of total foundation expenses was reported as being for charitable disbursements, not all foundations reported making charitable disbursements at this level. As shown in attachment XV, only about 73 percent of the foundations which reported some expenses reported disbursements for charitable purposes amounting to 90 percent or more of total expenses. Furthermore, some foundations' charitable disbursements seemed small in relation to their total expenses. For example, of the 3,426 foundations which incurred expenses totaling $100,000 to $1,000,000, about 55 reported making no charitable purpose disbursements and another 47 reported only making charitable purpose disbursements amounting to 1 to 39 percent of total expenses. Also, a few of the larger foundations reported making small charitable purpose disbursements in relation to their total expenses.

The results are similar when using a more encompassing measure of charitable purpose expenditures--distributions qualifying as charitable expenditures under the Internal Revenue Code's minimum payout provision. In general, such qualifying distributions as defined in Section 4942(g) of the Internal Revenue Code include the charitable purpose disbursements I previously described, plus amounts paid for program related investments, amounts paid to acquire assets used directly to carry out charitable purposes, and amounts set aside for specific charitable purpose projects. These latter amounts would generally not be fully recognized by the foundation as expenses during the year. As shown in attachment XVI, only about 74 percent of the foundations which reported some expenses reported making qualifying distributions equalling or exceeding 90 percent of total foundation expenses. However, we estimate that of the 3,426 foundations reporting expenses totaling $100,000 to $1 million, about 48 made no qualifying distributions and another 46 made qualifying distributions of only 1 to 39 percent of total expenses. Also, there were some larger foundations in the two categories just discussed.

It should be noted, however, that some foundations might have been applying more of their expenses to charitable purposes than was reported as exempt purpose disbursements or qualifying distributions. To the extent that a foundation's charitable activities produce revenues, such as charging for services provided to the public or operating a museum which charges admission, the foundation is required by IRS to report the associated expenses--up to the level of revenue earned--as an expense for computing adjusted net income. Foundations are instructed not to classify those expenses as disbursements for exempt purposes. Accordingly, the IRS data base we used does not permit an analysis of this type of situation, nor does any other historical data maintained by IRS.

Foundation charitable expenses in relationship to earnings

We also examined the relationship between foundations' charitable purpose expenditures and earnings. Again, we used two measures of charitable purpose activities--qualifying distributions and disbursements for charitable purposes. We then expressed them as percentages of adjusted net income--a measure of earnings that the Congress had defined as the amount available for funding charitable purpose activities.

As in the case of our analysis of the percentage of foundation expenses used for charitable purposes, we found that the majority of foundations reported disbursing or distributing 90 percent or more of their adjusted net income for charitable purposes. As shown in attachments XVII and XVIII, of the foundations reporting some adjusted net income,

--about 59 percent reported making disbursements for charitable purposes equal to or exceeding their adjusted net income,

--about 60 reported making qualifying distributions equal to or exceeding their adjusted net income, and

--about 12 percent reported such disbursements or distributions as amounting to 90 to 99 percent of their adjusted net income during the tax year.

A few foundations disbursed or distributed little in relationship to their adjusted net income. For example, of the 2,691 foundations which earned adjusted net income of at least $100,000,

--About 49 foundations, or almost 2 percent, made charitable purpose disbursements of less than 10 percent of adjusted net income and another 54, or about 2 percent, made such disbursements equalling 10 to 30 percent of adjusted net income.

--About 40, or about 1 percent, made qualifying distributions of less than 10 percent of adjusted net income and another 46, or about 1 percent, made such distributions equalling 10 to 30 percent of adjusted net income.

It should be noted that these are one year disbursement and distribution statistics, and may not be indicative of the multi-year spending patterns of the foundations. For tax year 1979, the Internal Revenue Code required most foundations to make qualifying distributions in an amount at least equal to their adjusted net income less certain taxes and adjustments. However, the Code also authorized foundations to apply any excess qualifying distributions from the 5 preceding years to their qualifying distribution requirement. In addition, the Code authorized foundations to make the required qualifying distributions during the year following the year of the earnings. The data base we analyzed did not contain sufficient information to allow us to determine how these multi-year considerations affected private foundation expenditure patterns. Accordingly, our analysis was limited to the foundations' tax year disbursements for charitable purposes and qualifying distributions.

PUBLIC INFORMATION REPORTING BY TAX-EXEMPT PRIVATE FOUNDATIONS NEEDS MORE ATTENTION BY IRS

As we have discussed today, foundations hold vast resources dedicated to public purposes and provide considerable contributions to support charitable organizations. Accordingly, the Internal Revenue Code requires private foundations to make extensive public disclosures on their returns filed with IRS. Such information is useful to grant seekers for identifying those foundations most likely to fund their proposals and to IRS, the Congress, and the public for monitoring foundation activities. This Subcommittee's inquiry is a good example of the uses of and need for such information.

With reductions in Federal spending, such as federal aid to education, health, and social welfare, many people will look to tax-exempt private foundations to help fill the gap; and the need for complete and accurate public reporting by foundations will become even more important. In view of this, we recently evaluated for the Chairman of the House Government Operations Subcommittee on Commerce, Consumer, and Monetary Affairs, how well IRS assures that private foundations comply with the reporting requirements of the Internal Revenue Code. On May 11, 1983, we testified before that Subcommittee on our findings, conclusions, and recommendations. We expect to issue our final report shortly.

In summary, we found that private foundations generally comply well with those reporting requirements which IRS through its actions has identified as being necessary for tax computation and enforcement purposes. Most foundations, however, did not comply as well with other statutorily required information that is useful to the public--information on grants, investments, and foundation management. This is because IRS has devoted less attention to enforcing those requirements.

Specifically, our analyses of foundation returns filed at three service centers showed that

--About 79 percent of the foundations' returns did not report complete information on grants paid during the year. Most significantly, about 59 percent did not report complete grant purpose descriptions and about 72 percent did not report grant recipient addresses.

--About 31 percent of the foundations' returns did not report complete information on asset holdings. Most significantly, about 28 percent did not adequately describe all securities and other assets.

--About 41 percent of the foundations' returns did not report complete information on those responsible for managing the foundation. Most significantly, 32 percent reported no information.

To assure that the Congress' and the public's information needs for oversight and grant seeking purposes are met, we recommended that IRS make certain administrative changes to better enforce those tax exemption reporting requirements. IRS agreed with our recommendations and is taking actions to strengthen its enforcement program and improve its management information system. These actions should help to assure that the public's oversight and grant-seeking information needs are met.

CONCLUDING REMARKS

To assure that private foundations serve public rather than private interests, the Congress enacted an extensive set of rules governing the operations of tax-exempt private foundations. Today, I have summarized the financial results of foundation operations--principally in tax year 1979--under those rules.

Although sizeable revenues are flowing into foundations, and although foundations are retaining increasing portions of these revenues, the data, when measured in constant dollars, shows that the market value of foundation assets has declined in recent years as have foundation disbursements for charitable purposes. Even so, the majority of money paid out by the private foundation community as a whole has been for charitable purposes--about $3.2 billion of $3.5 billion in total expenses for 1979, of which $2.8 billion was for grants or contributions. Also, the charitable disbursements of many foundations equalled or exceeded their adjusted net income--the amount generally deemed available for funding charitable activities.

Mr. Chairman, we believe that within the context of the law, a balance must be struck between the benefits to be derived from the operational freedom of private foundations and the need for regulation to assure that public purposes are served. Our statistical analyses of the financial aspects of foundation operations, standing alone, do not permit us to reach hard and fast conclusions as to whether foundations are properly balancing their operations between serving the public and meeting their own financial needs and whether there is a need for more or less regulation. What the proper balance should be can best be determined through the legislative process and public debate, as represented by hearings such as these. We trust that the information we have presented today will assist the Subcommittee and the Congress in making these determinations.

This concludes my statement. I would be pleased to respond to any questions.

OVERVIEW OF PRIVATE FOUNDATION RESOURCES AND EXPENSES AS MEASURED IN ACTUAL AND CONSTANT DOLLARS

1962 - 1981

Selected Years e/	Number of Foundations	Foundation Financial Data In Millions of Actual Dollars: Assets at Market Value	Total Receipts	Total Expenses	Disbursements for Exempt Purposes	Foundation Financial Data In Millions of Constant (1972) Dollars c/: Assets at Market Value	Total Receipts	Total Expenses	Disbursements For Exempt Purposes
1962	14,865	16,262	1,898	N/A	1,012	23,031	2,688	N/A	1,433 a/
1974	26,889	N/A	2,792	2,717	2,409	N/A	2,430	2,361	2,093 a/
1977	27,691	34,817	4,369	3,001	2,692	24,900	3,125	2,142	1,922 a/
1978	29,659	36,735	4,933	3,516	3,101	24,482	3,288	2,337	2,061 a/
1979	27,980	44,648	6,013	3,536	3,246	27,321	3,679	2,164	1,986 a/
1980	32,618	48,023	7,323	3,993	d/	26,882	4,099	2,235	d/ b/
1981	31,866	50,980	9,059	4,808	d/	26,075	4,633	2,459	d/ b/

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a/ Source is GAO analysis of data from SOI Bulletin (Pub. 1136) dated October 1982, and Private Foundations 1974-78 (Pub. 1073) dated April 1981, Statistics of Income Division, Internal Revenue Service, Department of the Treasury.

b/ Source is GAO analysis of IRS Master File data as reported to IRS Exempt Organizations Division.

c/ Implicit Price Deflator for Gross National Product as developed by the Department of Commerce, Bureau of Economic Analysis, was applied to actual dollars to compute constant 1972 dollars.

d/ Data not available. However, data on contributions paid, which based on prior year data generally accounts for about 85 percent of exempt purpose disbursements, totaled about $3.1 billion in 1980 and $3.7 billion in 1981 as measured in actual dollars. These contributions, in constant 1972 dollars amounted to about $1.8 billion in 1980 and $1.9 billion in 1981.

e/ Selected years were dictated by data availability.

ATTACHMENT II

ATTACHMENT II

OVERVIEW OF 1979 PRIVATE FOUNDATION REVENUE AND EXPENSES

BY SIZE AS MEASURED BY BOOK VALUE OF ASSETS

1 OF 3

	FOUNDATION ASSET SIZE AT BOOK VALUE						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
TOTAL NUMBER OF FOUNDATIONS	1,223	8,557	5,967	8,717	3,026	490	27,980
REVENUE:							
DONATIONS RECEIVED ($)	4,499,589	79,175,936	81,180,776	339,931,956	667,075,340	1,115,655,784	2,287,519,331
% OF TOTAL REVENUE	85	84	73	55	42	31	38
NUMBER OF FOUNDATIONS	238	4,397	2,701	3,786	1,374	212	12,708
% OF TOTAL FOUNDATIONS	19	51	45	43	45	43	45
PASSIVE INCOME ($)	1,945,635	7,698,883	23,651,044	226,529,704	676,086,575	1,681,701,251	2,617,613,093
% OF TOTAL REVENUE	37	8	21	36	43	47	44
NUMBER OF FOUNDATIONS	281	5,395	5,636	8,540	3,002	483	23,339
% OF TOTAL FOUNDATIONS	23	63	94	98	99	99	83
BUSINESS INCOME ($)	0	2,572,875	1,735,786	7,730,919	26,598,952	11,825,563	50,464,095
% OF TOTAL REVENUE	0	3	2	1	2	0	1
NUMBER OF FOUNDATIONS	0	230	98	166	105	35	626
% OF TOTAL FOUNDATIONS	0	3	2	2	3	7	2
OTHER INCOME ($)	-1,127,277	4,549,527	4,851,987	47,428,441	202,533,409	799,292,352	1,057,528,440
% OF TOTAL REVENUE	-21	5	4	8	13	22	18
NUMBER OF FOUNDATIONS	55	1,435	1,841	4,549	2,338	424	10,641
% OF TOTAL FOUNDATIONS	4	17	31	52	77	87	38
TOTAL REVENUE ($)	5,317,948	93,997,221	111,419,543	621,621,021	1,572,294,275	3,608,474,950	6,013,124,957
NUMBER OF FOUNDATIONS	450	7,421	5,919	8,684	3,023	488	25,985
% OF TOTAL FOUNDATIONS	37	87	99	100	100	100	93

ATTACHMENT II

ATTACHMENT II

OVERVIEW OF 1979 PRIVATE FOUNDATION REVENUE AND EXPENSES

BY SIZE AS MEASURED BY BOOK VALUE OF ASSETS

2 OF 3

	FOUNDATION ASSET SIZE AT BOOK VALUE						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
EXPENSES:							
COMPENSATION ($)	346,521	17,273,432	7,792,545	27,918,181	80,175,549	135,075,704	268,573,932
% OF TOTAL EXPENSES	3	16	9	6	8	7	8
NUMBER OF FOUNDATIONS	88	890	1,098	2,670	1,581	369	6,697
% OF TOTAL FOUNDATIONS	7	10	18	31	52	75	24
PROFESSIONAL SERVICES ($)	359,547	2,351,192	2,407,016	11,781,705	24,303,641	40,227,138	81,430,239
% OF TOTAL EXPENSES	3	2	3	3	2	2	2
NUMBER OF FOUNDATIONS	223	2,320	2,773	5,181	2,295	434	13,226
% OF TOTAL FOUNDATIONS	18	27	46	59	76	89	47
CONTRIBUTIONS ($)	9,638,324	76,611,972	66,140,423	355,048,655	775,515,591	1,518,044,591	2,800,999,557
% OF TOTAL EXPENSES	78	70	76	80	77	81	79
NUMBER OF FOUNDATIONS	372	5,927	5,226	7,896	2,683	460	22,564
% OF TOTAL FOUNDATIONS	30	69	88	91	89	94	81
OTHER EXPENSES ($)	1,945,553	13,629,904	11,157,875	49,069,436	126,571,619	182,392,282	384,766,668
% OF TOTAL EXPENSES	16	12	13	11	13	10	11
NUMBER OF FOUNDATIONS	372	6,654	5,647	8,509	2,993	481	24,655
% OF TOTAL FOUNDATIONS	30	78	95	98	99	98	88
TOTAL EXPENSES ($)	12,289,945	109,866,499	87,497,859	443,809,977	1,006,566,400	1,875,739,715	3,535,770,396
NUMBER OF FOUNDATIONS	510	7,821	5,909	8,667	3,016	487	26,410
% OF TOTAL FOUNDATIONS	42	91	99	99	100	99	94
EXCESS REVENUE OVER EXPENSE	-6,972,023	-15,869,795	23,921,166	177,810,102	565,727,451	1,732,735,169	2,477,352,070
TOTAL NUMBER OF FOUNDATIONS	1,223	8,557	5,967	8,717	3,026	490	27,980

OVERVIEW OF 1979 PRIVATE FOUNDATION REVENUE AND EXPENSES

BY SIZE AS MEASURED BY BOOK VALUE OF ASSETS

	FOUNDATION ASSET SIZE AT BOOK VALUE						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
SUMMATION:							
FOUNDATIONS WITH EXCESS REVENUES	55	3,538	3,437	5,760	2,145	384	15,319
% OF TOTAL FOUNDATIONS	4	41	58	66	71	78	55
FOUNDATIONS WITH DEFICITS	319	4,359	2,456	2,905	871	104	11,014
% OF TOTAL FOUNDATIONS	26	51	41	33	29	21	39
FOUNDATIONS BREAKING EVEN	849	660	75	52	10	2	1,647
% OF TOTAL FOUNDATIONS	69	8	1	1	0	0	6
TOTAL NUMBER OF FOUNDATIONS	1,223	8,557	5,967	8,717	3,026	490	27,980

SOURCE: GAO ANALYSIS OF IRS STATISTICS OF INCOME DIVISION RANDOM SAMPLE DATABASE OF 1979 PRIVATE FOUNDATION RETURNS. DATA REPRESENTS ESTIMATES PROJECTED TO THE UNIVERSE OF FOUNDATIONS.

ATTACHMENT III

ATTACHMENT III

TYPE OF ASSETS AT BOOK VALUE HELD BY PRIVATE FOUNDATIONS DURING 1979 ACCORDING TO ASSET SIZE

	FOUNDATION ASSET SIZE AT BOOK VALUE						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
TOTAL NUMBER OF FOUNDATIONS	1,223	8,557	5,967	8,717	3,026	490	27,980
ASSETS:							
CASH ($)	0	31,302,549	91,611,666	457,192,984	673,833,010	757,369,221	2,011,309,429
% OF TOTAL ASSETS	0	49	28	15	8	3	6
NUMBER OF FOUNDATIONS	0	8,220	5,834	8,464	2,922	470	25,910
% OF TOTAL FOUNDATIONS	0	96	98	97	97	96	93
RECEIVABLES ($)	0	1,830,180	10,054,147	84,799,916	233,297,813	429,884,402	759,866,459
% OF TOTAL ASSETS	0	3	3	3	3	2	2
NUMBER OF FOUNDATIONS	0	660	758	1,787	1,004	246	4,455
% OF TOTAL FOUNDATIONS	0	8	13	20	33	50	16
INVENTORY ($)	0	303,408	1,446,563	9,205,163	18,016,569	10,740,196	39,711,899
% OF TOTAL ASSETS	0	0	0	0	0	0	0
NUMBER OF FOUNDATIONS	0	92	59	129	92	29	401
% OF TOTAL FOUNDATIONS	0	1	1	1	3	6	1
U.S. GOVERNEMENT OBLIGATIONS ($)	0	3,249,747	22,430,600	319,981,996	1,144,000,975	2,596,997,781	4,086,661,098
% OF TOTAL ASSETS	0	5	7	11	13	12	12
NUMBER OF FOUNDATIONS	0	358	822	2,877	1,728	340	6,126
% OF TOTAL FOUNDATIONS	0	4	14	33	57	69	22

TYPE OF ASSETS AT BOOK VALUE HELD BY PRIVATE FOUNDATIONS DURING 1979 ACCORDING TO ASSET SIZE

	FOUNDATION ASSET SIZE AT BOOK VALUE						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
TOTAL NUMBER OF FOUNDATIONS	1,223	8,557	5,967	8,717	3,026	490	27,980
STATE/LOCAL OBLIGATIONS ($)	0	281,795	1,100,6 06	8,971,356	32,163,304	23,722,991	66,240,052
% OF TOTAL ASSETS	0	0	0	0	0	0	0
NUMBER OF FOUNDATIONS	0	31	48	166	113	21	379
% OF TOTAL FOUNDATIONS	0	0	1	2	4	4	1
CORPORATE BONDS ($)	0	5,412,180	46,046,377	540,432,485	1,805,796,159	4,639,445,242	7,037,132,443
% OF TOTAL ASSETS	0	8	14	18	20	21	20
NUMBER OF FOUNDATIONS	0	752	1,832	4,679	2,207	406	9,876
% OF TOTAL FOUNDATIONS	0	9	31	54	73	83	35
CORPORATE STOCKS ($)	0	13,785,359	103,047,630	1,033,027,831	3,420,935,946	11,169,345,831	15,740,142,597
% OF TOTAL ASSETS	0	22	31	34	39	50	45
NUMBER OF FOUNDATIONS	0	1,612	3,006	6,030	2,561	430	13,639
% OF TOTAL FOUNDATIONS	0	19	50	69	85	88	49
MORTGAGE LOANS ($)	0	256,759	5,098,034	42,098,899	84,229,265	290,566,860	422,249,817
% OF TOTAL ASSETS	0	2	2	1	1	1	1
NUMBER OF FOUNDATIONS	0	61	198	542	343	75	1,219
% OF TOTAL FOUNDATIONS	0	1	3	6	11	15	4

ATTACHMENT III

ATTACHMENT III

TYPE OF ASSETS AT BOOK VALUE HELD BY PRIVATE FOUNDATIONS DURING 1979 ACCORDING TO ASSET SIZE

	FOUNDATION ASSET SIZE AT BOOK VALUE						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
TOTAL NUMBER OF FOUNDATIONS	1,223	8,557	5,967	8,717	3,026	490	27,980
DEP. ASSETS HELD FOR INVESTMENT ($)	0	15,749	745,325	29,502,068	81,456,545	111,879,543	223,599,231
% OF TOTAL ASSETS	0	0	0	1	1	0	1
NUMBER OF FOUNDATIONS	0	15	48	430	389	113	995
% OF TOTAL FOUNDATIONS	0	0	1	5	13	23	4
DEP. ASSETS HELD FOR CHARITY ($)	0	1,078,763	6,120,633	50,683,506	215,586,555	170,153,212	443,622,669
% OF TOTAL ASSETS	0	2	2	2	2	1	1
NUMBER OF FOUNDATIONS	0	404	240	578	470	139	1,832
% OF TOTAL FOUNDATIONS	0	5	4	7	16	28	7
LAND HELD FOR INVESTMENT ($)	0	23,025	4,264,503	48,241,992	135,782,530	189,736,442	378,048,491
% OF TOTAL ASSETS	0	0	1	2	2	1	1
NUMBER OF FOUNDATIONS	0	31	182	590	398	113	1,314
% OF TOTAL FOUNDATIONS	0	0	3	7	13	23	5
LAND HELD FOR CHARITABLE PURP. ($)	0	281,964	3,665,558	35,205,438	97,833,237	55,097,585	192,083,782
% OF TOTAL ASSETS	0	0	1	1	1	0	1
NUMBER OF FOUNDATIONS	0	77	150	455	324	75	1,080
% OF TOTAL FOUNDATIONS	0	1	3	5	11	15	4

ATTACHMENT III

TYPE OF ASSETS AT BOOK VALUE HELD BY PRIVATE FOUNDATIONS DURING 1979 ACCORDING TO ASSET SIZE

	FOUNDATION ASSET SIZE AT BOOK VALUE						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
TOTAL NUMBER OF FOUNDATIONS	1,223	8,557	5,967	8,717	3,026	490	27,980
OTHER INVESTMENTS ($)	0	4,445,513	27,421,356	245,520,185	569,413,292	1,392,631,711	2,239,432,058
% OF TOTAL ASSETS	0	7	8	8	6	6	6
NUMBER OF FOUNDATIONS	0	767	996	2,157	965	203	5,088
% OF TOTAL FOUNDATIONS	0	9	17	25	32	41	18
OTHER ASSETS ($)	0	1,422,039	10,041,991	92,654,504	302,524,822	621,280,779	1,027,924,135
% OF TOTAL ASSETS	0	2	3	3	3	3	3
NUMBER OF FOUNDATIONS	0	706	672	1,584	1,010	269	4,241
% OF TOTAL FOUNDATIONS	0	8	11	18	33	55	15
TOTAL ASSETS ($)	0	63,689,523	333,096,179	2,997,521,324	8,814,871,450	22,458,851,972	34,668,030,448
NUMBER OF FOUNDATIONS	0	8,557	5,967	8,717	3,026	490	26,757
% OF TOTAL FOUNDATIONS	0	100	100	100	100	100	96

SOURCE: GAO ANALYSIS OF IRS STATISTICS OF INCOME DIVISION RANDOM SAMPLE DATABASE OF 1979 PRIVATE FOUNDATION RETURNS. DATA REPRESENTS ESTIMATES PROJECTED TO THE UNIVERSE OF FOUNDATIONS.

ATTACHMENT IV

LIST OF PRIVATE FOUNDATIONS REPORTING ASSETS IN EXCESS OF $1 MILLION AND REPORTING A 2 PERCENT OR MORE OWNERSHIP IN A FOR-PROFIT BUSINESS RANKED BY THE FOUNDATION'S LARGEST STOCK HOLDING AS A PERCENTAGE OF FAIR MARKET VALUE OF ITS ASSETS

				CORPORATE STOCK									PERCENTAGE COMPARISONS			
						LARGEST HOLDING			SECOND LARGEST HOLDING							
FOUNDATION NAME	1/	ASSET AMOUNT ($000)	2/	TOTAL ($000)	2/	AMOUNT ($000)	2/	NAME	AMOUNT ($000)	2/	NAME	3/	4/	5/	FOOT-NOTES
Bremer, Otto Fnd	n	33672	m	77045	b	75458	b	Otto Bremer Company	1457	b	Amer Bankcorp Inc	224	4	98	
Apirstein, J S, F.	n	4545	m	5575	b	5575	b	American Greeting	---	-	-------------	123	000	100	
Wurlitzer, Farny R, F.	n	3268	m	4331	b	4331	b	Wurlitzer Co.	---	-	-------------	133	000	100	
Maclellan Fdn	n	65926	m	65883	m	65844	m	Provident Life/Acc Ins	38	m	Ancorp Bancshares	100	000	100	
Gannett Foundation	n	204980	m	220239	m	217469	m	Gannett Inc.	293	m	A T & T	106	000	99	1
MacClellan, R J,Trust	n	26606	m	26511	m	26511	m	Prov Life&Accident Ins	---	-	-------------	100	000	100	
Delaney, B P, Char Tr	n	32246	m	32099	m	32099	m	Stanadyne Inc	---	-	-------------	100	000	100	
Hollingsworth Fund In	n	2760	m	2760	m	2760	m	J D H on Wheels Inc	---	-	-------------	100	000	100	
Leviton Foundation Inc	n	1351	m	1346	m	1346	m	Leviton MFG Co Inc	---	-	-------------	100	000	100	A
Harris Bros F	n	2052	m	2051	m	2051	m	Harris Struc Steel Co	---	-	-------------	100	000	100	A
Kellogg, W K, Trust	n	626791	m	626220	m	626220	m	Kellogg Company	---	-	-------------	100	000	100	

1/ Type n indicates nonoperating foundations; o indicates operating foundation

2/ Type m or b indicates asset valuation at market or book, respectively

3/ Largest holding as a percent of total asset value

4/ Second largest holding as a percent of total asset value

5/ Largest holding as a percent of total stocks

ATTACHMENT IV

ATTACHMENT IV

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LIST OF PRIVATE FOUNDATIONS REPORTING ASSETS IN EXCESS OF $1 MILLION AND REPORTING A 2 PERCENT OR MORE OWN. SHIP IN A FOR-PROFIT BUSINESS RANKED BY THE FOUNDATION'S LARGEST STOCK HOLDING AS A PERCENTAGE OF FAIR MARKET VALUE OF ITS ASSETS

		ASSET		CORPORATE STOCK								PERCENTAGE COMPARISONS			
						LARGEST HOLDING			SECOND LARGEST HOLDING						
FOUNDATION NAME	1/	AMOUNT ($000)	2/	TOTAL ($000)	2/	AMOUNT ($000)	2/	NAME	AMOUNT ($000)	2/	NAME	3/	4/	5/	FOOT-NOTES
Raymond Foundation	n	1387	m	1369	m	1369	m	Raymond Corporation	---	-	-------------	100	000	100	A
Delaware Park Inc	n	2961	m	2961	m	2961	m	Delaware Racing Assn	---	-	-------------	100	000	100	
Retirement Research F	n	55626	m	54905	m	54905	m	Citizens Bank & Trust	----	-	-------------	99	000	100	
Webb, Del E, F.	n	20709	m	20561	m	20512	m	Del E Webb Corp.	38	m	A J Bayless Market Inc	99	000	100	
Grunfeld, H, Trust	n	13807	m	13678	m	13676	m	Metallurg Inc.	2	m	Texaco Inc	99	000	100	
Penn, William, Found.	n	68178	m	67590	b	67590	b	Rohm & Haas Co.	----	-	-------------	99	000	100	
Edison, Harry, F	n	11102	m	11099	m	10981	m	Edison Bros Stores Inc	46	m	I B M	99	000	99	
Chubb Foundation	n	2737	m	2679	m	2676	m	Chubb Corp	3	m	Exxon Corp	98	000	100	
Kendall, Geo, Fdn	n	11531	m	11287	m	11287	m	Washington National Co	----	--	-------------	98	000	100	
Harland, JH, Fdn Inc	n	7472	m	7424	m	7350	m	John Harland Co	16	m	HJ Heinz and Co	98	000	99	
Sage Foundation	n	22919	m	22519	m	22266	m	Tecumseh Products Co.	34	m	Norfolk&WesternRail C	97	000	100	
Dow, HH & GA, F.	n	90161	m	87826	m	87826	m	Dow Chemical Co.	---	-	-------------	97	000	100	
Meadows Fnd Inc.	n	123509	m	120575	m	119804	m	Gen Amer Oil Co /TX '	347	m	Gulf & Western Ind	97	000	99	
Gilmore, William G	n	9008	m	8906	m	8676	m	Gilmore Steel Corp	20	m	First Natl Boston	96	000	97	
Reichhold, Henry	n	1876	m	1781	m	1781	m	Reichhold Chemicals In	--	-	-------------	95	000	100	
McCreless, S & L, Fdn	n	3417	m	3331	m	3248	m	American Securities In	65	m	Alamo Sav Assoc	95	2	98	
Fuller, GF & SH, F	n	85127	m	79808	m	79808	m	Wyman-Gordon Co.	---	-	-------------	94	000	100	
Hoyt Foundation	n	2590	m	2431	m	2431	m	CPI Development Corp	---	-	-------------	94	000	100	
Starr Foundation	n	211397	m	199067	m	199050	m	Amer International Gr	13	m	I B M	94	000	100	
Dibner Fund Inc	n	16043	m	15382	m	15122	m	Burndy Corp	259	m	Evergreen Total RF Inc	94	2	98	
Roush Foundation	n	69851	m	65277	m	65277	m	Roadway Express Inc.	---	-	-------------	93	000	100	

ATTACHMENT IV

LIST OF PRIVATE FOUNDATIONS REPORTING ASSETS IN EXCESS OF $1 MILLION AND REPORTING A 2 PERCENT OR MORE OWNERSHIP IN A FOR-PROFIT BUSINESS RANKED BY THE FOUNDATION'S LARGEST STOCK HOLDING AS A PERCENTAGE OF FAIR MARKET VALUE OF ITS ASSETS

				CORPORATE STOCK								PERCENTAGE COMPARISONS			
						LARGEST HOLDING			SECOND LARGEST HOLDING						
FOUNDATION NAME	1/	ASSET AMOUNT ($000)	2/	TOTAL ($000)	2/	AMOUNT ($000)	2/	NAME	AMOUNT ($000)	2/	NAME	3/	4/	5/	FOOTNOTES
Gilmore, Earl B, F	n	6079	m	5667	m	5647	m	A F Gilmore Company	15	m	Gilmore C & Savings B	93	000	100	
Lilly Endowment Inc.	n	694067	m	645093	m	645093	m	Eli Lilly & Company	-----	-	-------------	93	000	100	
Kennedy, John R, F Inc	n	3939	m	3740	m	3652	m	Federal Paper Board Co	88	m	Midlantic Bank Inc	93	2	98	
Stemmons Fdn	n	1191	m	1090	m	1090	m	Industrial Properties	---	-	-------------	92	000	100	
Harris, Stanley G, F	n	4426	m	4346	m	4088	m	Harris Bank Corp Inc	51	m	Santa Fe Ind	92	1	94	
Heinz, Howard, Endow	n	101483	m	95715	m	92752	m	H J Heinz Co.	2781	m	601 Holding Co.	91	3	97	
Wallace, Dewitt, Fund	n	22301	m	21246	m	20276	m	Readers' Digest Assn.	68	m	I B M	91	000	95	A
Lakeview Fund Inc.	n	25242	m	23617	m	22639	m	Readers Digest Assoc.	68	m	I B M Corp.	90	000	96	A
Stoddard C Trust	n	38755	m	37220	m	34899	m	Wyman-Gordon Co	559	m	Texas Oil Gas Corp	90	1	94	
Luce, Henry, F Inc.	n	118549	m	112618	m	104157	m	Time Inc.	771	m	Freeport-McMoran Inc.	88	1	92	A
Boswell, J G, Fdn	n	47130	m	40852	m	40852	m	J G Boswell Co	----	-	-------------	87	000	100	
Essick Foundation Inc	n *	1669	m	1452	m	1433	m	Essick Investment Inc	10	m	Figgie International	86	1	99	
Ahmanson F.	n	119592	m	100891	m	100891	m	H F Ahmanson & Co.	----	-	-------------	84	000	100	C
Kaplan-Halpert	n	4866	m	4127	m	4103	m	Kaplan Trucking Co	17	m	AT&T	84	000	99	
L A W Fund Inc	n	30253	m	27665	m	25285	m	Readers Digest Assoc.	182	m	I B M Corp.	84	1	91	A
Blaisdell, P & S, F	n	1894	m	1567	m	1567	m	Zippo Manufacturing Co	----	-	-------------	83	000	100	
Zale Foundation	n	7539	m	6648	m	6257	m	Zale Corp	85	m	IBM	83	1	94	
Danforth F.	n	92390	m	84230	m	77022	m	Ralston Purina Co.	584	m	Atlantic Richfield	83	1	91	
Markey, J C, C Fund	n	1595	m	1304	b	1304	b	Aro Corp	----	-	-------------	82	000	100	
Heuss-Helms F Inc	n	2382	m	1956	m	1956	m	Telephone Service Co	200	m	Buckland Telephone Co	82	8	100	
Jones, W Alton, F Inc.	n	99860	m	92683	m	82151	m	Cities Service Co.	450	m	Avon Products Inc.	82	000	89	

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				CORPORATE STOCK								PERCENTAGE COMPARISONS			
						LARGEST HOLDING			SECOND LARGEST HOLDING						
FOUNDATION NAME	1/	ASSET AMOUNT ($000)	2/	TOTAL ($000)	2/	AMOUNT ($000)	2/	NAME	AMOUNT ($000)	2/	NAME	3/	4/	5/	FOOT-NOTES
Dickson, R H, Family F	n	2592	m	2393	m	2118	m	Ruddick Corporation	87	m	Hamby Investments Inc	82	3	89	
Blaffer, Robert L, Tr	o	1141	m	312	m	255	m	Suburban Realty corp.	33	m	G T & E	82	3	82	
Stone, France, Fdn	n	4085	m	3305	m	3305	m	France Stone Co.	---	-	-----------	81	000	100	
Republic Steel E&C T	n	10041	m	8084	m	8084	m	Republic Steel Corp.	---	-	-----------	81	000	100	
Olmstead,Geo Fdn	n	7554	m	6570	m	6138	m	International Bank	301	m	United Serv Life Ins	81	4	93	
El Pomar Foundation	n	81852	m	68230	m	65266	m	El Pomar Invest Co.	1016	m	Phillips Petroleum Co	80	1	96	
Hewlett,W & F, F.	n	316053	m	282386	m	251471	m	Hewlett Packard Co.	1570	m	Super Valu Stores Inc	80	000	89	A
Maytag, F, Family F	n	8999	m	7609	m	7079	m	Maytag Company	171	m	Standard Oil of Ind.	79	2	93	
Gerlach Fdn Inc.	n	1858	m	1701	m	1472	m	Lancaster Colony Corp	48	m	Lehrs, Inc.	79	3	87	
Deitrich, D W	n	4989	m	3918	m	3916	m	Dietrich Corp	---	-	----------	78	000	100	
Cousins F Inc	n	2522	m	2119	b	1969	b	Omni Prod Co of Ga	150	b	Cousins Properties inc	78	6	93	
Vollmer Foundation	n	13206	m	11816	m	10538	m	CA Venezolana de Cem	1054	m	CA Electric de Caracus	78	8	87	
Johnson, Robert W, F.	n	1007822	m	826310	m	777951	m	Johnson & Johnson	2843	c	I B M	77	000	94	
Alden, George I, T.	n	54997	m	46162	m	42265	m	Norton Company	312	m	Standard Oil of Ind.	77	1	92	
Tandy, AR & CD, F	n	165760	m	149082	m	128304	m	Tandy Corp.	5476	m	Color Tile Inc.	77	3	87	
Whitaker Fdn	n	88007	m	77952	m	67511	m	A M P Inc.	689	m	Scudder Develop. Fund	76	1	91	
Atkinson, M K, Fdn	n	16470	m	14301	m	12539	m	G F Atkinson Co	212	m	BankAmerica Corp	76	1	89	
McArthur, JD & CT, F	n	934939	m	700000	b	700000	b	Bankers Life&CasualtyC.	----	-	-------------	75	000	100	
Rogers, McFeely, Fdn	n	3169	m	2581	m	2372	m	Latrobe Die Casting Co	38	m	Gulf Oil Corp	75	1	92	
High Winds Fund Inc.	n	23949	m	19190	m	17794	m	Readers' Digest Assn.	91	m	I B M	74	000	93	A
Trebor Foundation	n	22409	m	19868	m	16665	m	Coca-Cola Co.	346	m	J P Morgan & Co Inc.	74	2	84	

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LIST OF PRIVATE FOUNDATIONS REPORTING ASSETS IN EXCESS OF $1 MILLION
AND REPORTING A 2 PERCENT OR MORE OWNERSHIP IN A FOR-PROFIT BUSINESS RANKED BY
THE FOUNDATION'S LARGEST STOCK HOLDING AS A PERCENTAGE OF FAIR MARKET VALUE OF ITS ASSETS

FOUNDATION NAME	1/	ASSET AMOUNT ($000)	2/	CORPORATE STOCK TOTAL ($000)	2/	LARGEST HOLDING AMOUNT ($000)	2/	LARGEST HOLDING NAME	SECOND LARGEST HOLDING AMOUNT ($000)	2/	SECOND LARGEST HOLDING NAME	PERCENTAGE COMPARISONS 3/	4/	5/	FOOT-NOTES
Reeves Bros Fdn Inc	n	5708	m	5390	m	4006	m	Reeve Brothers, Inc	634	m	I B M	74	11	74	
Noble, S R, Fdn Inc	n	396378	m	276021	m	243621		Noble Affiliates Inc	1780	m	United Telecom Inc	72	1	88	
Millikin, James, Tr.	n	10835	m	8237	m	7725	m	Millikin B Inc	83	m	Norfolk Western R	71	1	94	
Ellison Fdn	n	1196	m	924	m	846	m	Proctor Ellison Co	49	m	Exxon Corp	71	4	92	
Whitehead, Lettie, Fdn	n	39507	m	36627	m	27480	m	Coca Cola Co	2426	m	Coca Cola Bottl Co NY	70	6	75	
Pew Memorial T	n	1022998	m	842009	m	706247	m	Sun Company Inc.	7872	m	A T & T	69	1	84	
Whitehead, Joseph B, F	n	53037	m	45990	m	36484	m	Coca-Cola Co.	5235	m	Coca-Cola Bottling Co.	69	6	79	
Kieckhefer, J W, F	n	8439	m	6099	m	5680	m	Weyerhaeuser Company	134	m	Utah Power & Light	67	2	93	
Evjue, William T, C, T	n	6775	m	5128	m	4515	m	Capital Times Co	105	m	AT&T	67	2	88	A
Ware Foundation	n	8029	m	7352	m	5411	m	American Water Works	1240	m	York Water Company	67	15	74	
Victoria Fdn Inc	n	33625	m	22263	m	22263	m	Chubb Corp.	---	-	------------	66	000	100	
Woods Charitable Fdn	n	28218	m	20750	m	18499	m	Sahara Coal Co.	947	m	------------	66	3	89	
Duke Endowment	n	408513	m	339842	m	268848	m	Duke Power Company	5125	m	Aluminum Co of Amer.	66	1	79	
Cowles Char T	n	3993	m	3421	m	2633	m	Cowles Commu	165	m	Mapco Ind	66	4	77	
Beveridge, F S, Fdn	n	12537	m	8254	m	8055	m	Stanley Home Prod Inc	77	m	Bay Banks Inc	64	1	98	A
Kirby, F M, F, Inc.	n	83262	m	76576	m	55199	m	Alleghany Corp.	10132	m	Pittston	64	12	69	
Schafer, RH & A, Fdn	n	4254	m	4235	m	2708	m	Ohio Road Paving Co.	1275	m	Warren Slag Co.	64	30	64	
Blair, C M, W, Tr.	n	10370	m	7482	m	6045	m	Blair Co.	590	m	Standard Oil Co, Ind	63	5	87	
Mass-Weller Fdn	n	2076	m	2062	m	1314	m	Gramll Commercial	748	m	Depositos De Lima	63	38	64	
Bartlett, EB & MI	n	3311	m	3309	m	2080	m	Bartlett Collins	239	m	Reading & Bates	63	7	83	
Willett, H L, F, Inc	n	3405	m	2111	m	2111	m	Willett Inc	---	-	-------------	62	000	100	

ATTACHMENT IV

LIST OF PRIVATE FOUNDATIONS REPORTING ASSETS IN EXCESS OF $1 MILLION AND REPORTING A 2 PERCENT OR MORE OWNERSHIP IN A FOR-PROFIT BUSINESS RANKED BY THE FOUNDATION'S LARGEST STOCK HOLDING AS A PERCENTAGE OF FAIR MARKET VALUE OF ITS ASSETS

		ASSET		CORPORATE STOCK								PERCENTAGE COMPARISONS			
						LARGEST HOLDING			SECOND LARGEST HOLDING						
FOUNDATION NAME	1/	AMOUNT ($000)	2/	TOTAL ($000)	2/	AMOUNT ($000)	2/	NAME	AMOUNT ($000)	2/	NAME	3/	4/	5/	FOOT-NOTES
Honey, Wm E, Fdn	n	2103	m	1475	m	1357	m	Latex Construction	117	m	Flint Construction Co	62	5	92	
Myrin, Mabel Pew, T.	n	145419	m	111536	m	90090	m	Sun Oil Company	1900	m	Baker Intl Corp.	62	1	81	
Russell, B & R, E&C F	n	8790	m	6942	m	5420	m	Russell Corporation	341	m	EF Hutton Cash Reserv	62	4	78	
Slemp Foundation	n	3604	m	2945	m	2240	m	Kentucky River Coal Cp	705	m	Exxon Corp	62	6	76	
Altman Foundation	n	11631	m	11338	m	7114	m	B Altman Co	1302	m	A T & T Co	61	11	65	
Richardson, J, F	n	7810	m	7024	m	4685	m	Richardson-Vicks Inc	1395	m	Dow Chemicals Co	60	18	67	
Chambers, James B	n	2126	m	1269	m	1254	m	F N Bank of Wheeling	14	m	Security National B	59	1	99	
Evans, Lettie Pate, F	n	16492	m	13240	m	9769	m	Coca Cola Co	2042	m	Coca-Cola Bottling Cos	59	12	74	
Lowenstein, Leon, Fdn	n	19389	m	16960	m	11455	m	M Lowenstein Corp.	525	m	Exxon Corporation	59	3	68	A
Stewart, Guy T, Fdn	n	2491	m	1471	b	1415	b	Stewart Investment Co	40	b	Guy Chevrolet Sales	57	2	96	
Feldman Foundation	n	5331	m	3159	m	3046	m	Commercial Metals Co.	67	m	Tourist Ind Dvlp Corp.	57	1	96	
Timken Intern Fund	n	12424	m	6920	b	6920	h	Timken Company	---	-	----------------------	56	000	100	
Lamb, KS & MB, F	n	4463	m	3640	m	2491	m	Lane Inc	704	m	C B Drug Co	56	10	68	
Francis, Parker B, Fdn	n	20336	m	16629	m	11211	m	Puritan-Bennett Corp	333	m	Marathon Oil Co.	55	2	67	
Hollberger F Inc	n	7368	m	7136	m	3945	m	Merchants Terminal Cor	2680	m	The Oil Fund Inc	54	36	56	
Kiewit, Peter, F	n	31616	m	18914	b	16605	h	Omaha World Herald	1206	b	Eastman Kodak	53	4	88	
Reeves Foundation	n	7030	m	4958	m	2577	m	Reeves Banking&Trust	1325	m	Cyclops Corp	53	19	52	
Hoover Foundation	n	14219	m	10925	m	7293	m	Hoover Co.	155	m	Combustion Eng. Inc.	51	1	67	
Murphy, John P, F	n	11103	m	9575	m	5609	m	Higbee Company	382	m	T R W Inc.	51	3	59	
Smith Richardson F In	n	95028	m	85367	m	48600	m	Richardson-Vicks Inc.	14470	m	Dow Chemical	51	15	57	
Murphy, Dan, F	n	103639	m	89658	m	51477	m	Calif Port Cement Co.	32516	m	Standard Oil of Calif.	50	31	57	

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LIST OF PRIVATE FOUNDATIONS REPORTING ASSETS IN EXCESS OF $1 MILLION AND REPORTING A 2 PERCENT OR MORE OWNERSHIP IN A FOR-PROFIT BUSINESS RANKED BY THE FOUNDATION'S LARGEST STOCK HOLDING AS A PERCENTAGE OF FAIR MARKET VALUE OF ITS ASSETS

		ASSET		CORPORATE STOCK									PERCENTAGE COMPARISONS			
						LARGEST HOLDING			SECOND LARGEST HOLDING							
FOUNDATION NAME	1/	AMOUNT ($000)	2/	TOTAL ($000)	2/	AMOUNT ($000)	2/	NAME	AMOUNT ($000)	2/	NAME		3/	4/	5/	FOOT-NOTES
Richardson, H S, Ch T	n	14193	a	10231	a	6985	a	Richardson-Vicks Inc	2597	a	Dow Chemical Co.		49	18	68	
Simon, SH & L, Fdn	n	6074	a	3989	b	2416	b	Simco Stores	31	b	I B M		40	1	81	
Higgins, Aldus C, F	n	1863	a	1394	a	885	a	Norton Company	50	a	Scudder Cash Inves Tr		48	3	63	
Famillian, I&S, Fam F.	n	1408	a	678	a	659	a	Famillian Realty Inv Corp	100	a	Israel Invest Corp		47	7	97	
Katzenberger F	n	2555	a	1925	a	1201	a	Advert Checking Bur	152	a	IBM		47	6	62	
Olin Foundation Inc.	n	115894	a	93448	a	54525	a	Federal Cartridge Corp	3475	a	First Bank System Inc		47	3	58	
Cook Bros E F Inc	n	3823	a	3821	a	1800	a	Community Bank	1250	a	First Fin C of West		47	33	47	A
Dreyfus Medical F	o	3453	a	1599	a	1597	a	Dreyfus Corp	1	a	Evans Products		46	000	100	
Publicker, H&R, Tr	n	7703	a	6310	a	3579	a	Wrigley (Wm) Jr Co	490	a	Texaco		46	6	57	
Offield Family Fdn	n	761	a	343	a	343	a	Publicker Ind, Inc.	---	-	----------		45	000	100	
First E&C Tr of Canton	n	3118	a	1418	b	1418	b	Timken Co	---	-	----------		45	000	100	
Haynes, JR & D, Fdn	n	19565	a	12861	a	8749	a	Union Oil California	2471	a	American M Fund Inc		45	13	68	
Stranahan Foundation	n	22362	a	19984	a	10030	a	Champion Spark Plug C.	321	a	American Home Prod Cor		45	1	50	
Gund, George, Fnd.	n	83638	a	69055	a	36911	a	Kellog Co.	9067	a	Cleveland-Cliffs Iron		44	12	53	
NPW Foundation	n	4807	a	4715	a	2123	a	Pinkerton Hold Corp.	1534	a	Pinkerton Inc.		44	32	45	
Mandel, J H L, F	n	2179	a	1733	a	940	a	Premier Ind Corp	50	a	Exxon Corp		43	2	54	
Mayer, M & EB, Fdn	n	316	a	134	a	134	a	Mazor Masterpieces Inc	---	--	------------		42	000	100	
McDonnell Fdn	n	57594	a	26118	a	24232	a	McDonnell Douglas Corp.	1090	a	General Electric Co		42	2	93	
Blaustein, J A, Fdn	n	38978	a	21033	a	16432	a	Amer Trading&Prod Corp	2631	a	Standard Oil of Ind.		42	7	78	
Pinkerton Foundation	n	5054	a	3275	a	2123	a	Pinkerton Holding Corp	1152	a	Pinkerton's Inc		42	23	65	L
Hillsdale Fund Inc	n	6481	a *	5880	a	2735	a	Richardson-Vicks Inc	545	a	Dow Chemical Co		42	8	47	

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LIST OF PRIVATE FOUNDATIONS REPORTING ASSETS IN EXCESS OF $1 MILLION AND REPORTING A 2 PERCENT OR MORE OWNERSHIP IN A FOR-PROFIT BUSINESS RANKED BY THE FOUNDATION'S LARGEST STOCK HOLDING AS A PERCENTAGE OF FAIR MARKET VALUE OF ITS ASSETS

		ASSET		CORPORATE STOCK								PERCENTAGE COMPARISONS			
						LARGEST HOLDING			SECOND LARGEST HOLDING						
FOUNDATION NAME	1/	AMOUNT ($000)	2/	TOTAL ($000)	2/	AMOUNT ($000)	2/	NAME	AMOUNT ($000)	2/	NAME	3/	4/	5/	FOOT-NOTES
Mach, J S, Fdn	n	3908	m	1619	m	1619	m	GC Murphy Co	---	-	--------------	41	000	100	
J J C Foundation Inc	n	1946	m	1099	b	802	b	United Tool & Die	298	b	(Public Traded Stock)	41	15	75	
Warren, William K, F	n	122872	m	98999	m	50770	m	Gulf Oil Corp.	15225	m	Warren American Oil C.	41	12	52	
Monfort Char Fdn	n	1173	m	464	m	464	m	Monfort of Colorado	---	-	--------------	40	000	100	
Johnson, Howard, F	n	2719	m	1090	m	1080	m	Jon Co Inc	---	-	--------------	40	000	100	
Harriman, G & R, F	n	26088	m	18227	m	10400	m	Union Pacific Corp.	650	m	Doubleday	40	2	57	
Houston Endow Fund	n	254929	m	128652	m	100090	m	Houston Chron Pub Co.	4312	m	Texas Commerce Bank	39	2	79	
Franklin, J & M, Fdn	n	12629	m	7579	m	4890	m	Audichron	317	m	Exxon Corp	39	2	65	
Educational F of Amer	n	21961	m	16832	m	8516	m	Prentice-Hall	856	m	Kansas City South Ind	39	4	51	
Large Foundation	n	2228	m	2176	m	871	m	Hunterdon Co, Natl Bnk	690	m	Eastman Kodak	39	29	40	
Hulshing Fnd, Inc	n	2430	m	2419	m	950	m	C L Hulshing & Co	703	m	Merck & Co Inc	39	32	40	
Bundy Foundation	n	2638	m	2240	m	1015	m	Bundy Corporation	78	m	CSX Corporation	38	3	45	
Hardin, Phil, Fdn	n	9480	m	6046	m	3494	m	Hardins Bakeries Corp	364	m	'A T & T	37	4	58	
Weinstein, J, Fdn	n	1331	m	1154	m	474	m	J W Mays Inc	315	m	Standard Oil of Ind	36	24	41	
Boettcher Fdn	n	80950	m	36139	m	28143	m	Ideal Basic Industries	5651	m	United Banks of Col.	35	7	78	
Svenson, Ernest, Fdn	n	2326	m	2284	m	817	b	John Barnes Corp	166	b	Odin Svenson Corp	35	7	36	
McIntosh Fdn	n	8239	m	2978	b	2809	m	Great A&P Tea Co	124	m	Union Pacific Corp	34	2	94	A
Moody Foundn		204051	m	72727	b	68390	b	American Natl Insur Co	1576	b	Gal-Tex Hotel Corp.	34	1	94	
Timken F of Canton	n	88515	m	38127	m	29892	m	Timken Company	3681	b	Rockwell Intl	34	4	78	
Mangeloff Foundation	n	1268	m	595	m	432	m	J B Kendall Co	43	m	Mobil Corp	34	3	73	
Fairchild, Sherman, F	n	113766	m	54034	m	38518		I B M Corp.	2939	m	Fairchild Ind Inc.	34	3	71	

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LIST OF PRIVATE FOUNDATIONS REPORTING ASSETS IN EXCESS OF $1 MILLION
AND REPORTING A 2 PERCENT OR MORE OWNERSHIP IN A FOR-PROFIT BUSINESS RANKED BY
THE FOUNDATION'S LARGEST STOCK HOLDING AS A PERCENTAGE OF FAIR MARKET VALUE OF ITS ASSETS

				CORPORATE STOCK									PERCENTAGE COMPARISONS			
						LARGEST HOLDING			SECOND LARGEST HOLDING							
FOUNDATION NAME	1/	ASSET AMOUNT ($000)	2/	TOTAL ($000)	2/	AMOUNT ($000)	2/	NAME	AMOUNT ($000)	2/	NAME	3/	4/	5/	FOOT-NOTES
Winslow, W R, R'Tr	n	5219	a	2624	a	1704	a	WR Winslow Cos	64	a	Becker Paint Glass Co	33	1	65	
Imerman, Stanley J, F	n	1808	a	1030	a	591	a	J Imerman Industries	94	a	Ford Motor Company	33	5	57	
Wickes, H R, Fdn	n	13029	a	7936	a	4563	a	Michigan Natl Corp	1456	a	Wickes Companies Inc	33	11	55	
Anderson, M D, Fdn	n	70467	a	42263	a	22231	a	Southwest Bancshares	8830	a	First City Bancorp /TX	32	13	53	
Forest Lawn Found	n	2070	a	2196	a	902	a	Amerl Secur&Fidel Cor	67	a	Baxter Travenol	31	2	41	
Coors, Adolph, Fdn	n	55984	a	48746	a	16980	a	Adolph Coors Co.	1711	a	Cray Research Inc.	31	3	35	
Kerr Foundation Inc	n	51341	a	36281	a	15537	a	Kerr McGee Corp.	1462	a	Appache Corp.	30	3	42	
McCormick, R R, Ch Tr	n	14913	a	12951	a	4498	a	Lake Shore Natl Bank	804	a	Phillip Morris Inc	30	5	35	
Dickson F Inc	n	4085	a	3749	a	1425	a	Ruddick Corp	371	a	NCNB Corporation	29	8	38	
Hindemann Fdn Inc	n	1928	a	1078	a	565	a	Nestle-Lemur Co	104	a	Standard Oil Of Ind	29	5	52	
Mandeville Fdn Inc	n	5296	a	5273	a	1545	a	White Consol Ind	530	a	Pewall Inc	29	10	29	
Jay, GS & GA, Fdn	n	1227	a	434	a	349	a	Geo Jay Drug Co	37	a	AT & T	28	3	80	
Buell, Temple Hoyne, F	n	3047	a	1241	b	857	b	Buell Development	132	b	Mobil Oil Corp	28	4	69	
Cain, E & W, Fdn	n	22936	a	13339	a	6441	a	Southern Union Co	5527	a	Supron Energy	28	24	48	
Longwood Fdn Inc	n	112051	a	83637	a	31137	a	EI duPont deNemours Co.	3789	a	General Motors Corp.	28	3	37	
Schmidlapp, TR U/W JB	n	17769	a	15415	a	5006	a	Xerox Corp.	772	a	Standard Oil Co of Ind	28	4	32	
Rogers Foundation	n	2064	a	1816	a	780	a	R H Rogers Invest Co	242	a	Standard Oil of Ind	27	8	43	
Kaiser, Henry J, F	n	221352	a	154534	a	60583	a	Kaiser Alum & Chem Cor	5319	a	Kaiser Steel Corp	27	2	39	
Muchnic Foundation	n	2298	a	866	b	506	b	Valley Company Inc	46	b	Discount Corp/New York	26	2	68	
Cannon Foundation Inc	n	34008	a	10737	b	8629	b	Cannon Mills Co	1172	b	Concord Telephone Co	25	3	80	
Haas Jr, E & W, Fund	n	14594	a	8447	a	3644	a	Levi Strauss & Co.	220	a	Schlumberger, LTD.	25	2	43	

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				CORPORATE STOCK								PERCENTAGE COMPARISONS			
						LARGEST HOLDING			SECOND LARGEST HOLDING						
FOUNDATION NAME	1/	ASSET AMOUNT ($000)	2/	TOTAL ($000)	2/	AMOUNT ($000)	2/	NAME	AMOUNT ($000)	2/	NAME	3/	4/	5/	FOOTNOTES
Liberty Fund Inc	o	46694	m	28101	m	11866	m	Continental Telephone	3112	m	AMAX Inc	25	7	42	
Herrick Foundation	n	89912	m	21212	b	21212	b	Tecumseh Products Co.	----	-	---------	24	000	100	
Abney Foundation	n	14384	m	6358	m	3493	m	Abney Mills	268	m	Baxter Travenol Labs	24	2	55	
DeMoss, Arthur S, F	o	19897	m	8725	m	4803	m	Templeton World Fund	171	m	Fidelcor Inc.	24	1	55	
Mine Saftey Ap Co C Tr	n	2336	m	1177	m	511	m	Char & Co	61	m	Rohm & Haas	22	3	43	
Mellon, Richard King,F	n	357217	m	220886	m	78157	m	General Re Corp Del	24218	m	Gulf Oil Corp.	22	7	34	
Emporium Foundation	n	1678	m	978	m	354	m	G T Electronic Corp	346	m	Bucktail Bank & T Co	21	21	36	
Irwin-Sweeney-Miller F	n	3238	m	703	m	637	m	Cummins Engine Co Inc	65	m	Lewellen Manufac Co	20	2	91	A
Cafritz, M & G, Fdn	n	59015	m	18162	b	11666	b	Ambassador Inc	3278	b	Cafritz Building Inc	20	5	64	
Whiting Foundation	n	4722	m	2002	m	944	m	Citizens Commercial	65	m	AT&T	20	1	47	
Dextra B M F Inc	n	1806	m	1151	m	370	m	United Aircraft P Inc	357	m	Baldwin Hills Co	20	20	32	
Morton, G, Memor Corp	n	1878	m	1322	m	378	m	Thomas Industries Inc	122	m	Uptown Ntl Bank/Chic.	20	6	29	
Rubin, CH & MB, F F	n	3037	m	2611	m	621	m	Tootsie Roll Ind Inc.	100	m	Dreyfus Corp.	20	3	24	
Ross Family Fdn	n	821	m	178	m	35	m	A T & T	3	m	Old Stone Corp	20	000	20	
Levin, M & A, Fdn	n	4033	m	1290	m	756	b	Meadeville Corp	115	m	AT&T	19	3	60	K
Maguire Fdn Inc	n	4636	m	3145	m	858	m	United Technologies	518	m	Quanex Corp	19	11	27	
Brown, Fdn	n	239738	m	182734	m	46361	m	Halliburton Co.	20870	m	Texas Eastern Corp.	19	9	25	
Schacht, L, Fdn	n	1080	m	1078	m	208	m	Marathon Oil	177	m	Fairmont Oil	19	16	19	
Bradley Family F.	n	2985	m	533	b	533	b	Zita Inc.	--	-	---------------	18	000	100	
Hess Foundation Inc.	n	66275	m	11821	b	11821	b	Amerada Hess Corp.	---	-	---------------	18	000	100	
Landegger Char F Inc	n	1827	m	328	b	328	b	Parsons & Whittemore	---	-	---------------	18	000	100	

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		ASSET		CORPORATE STOCK								PERCENTAGE COMPARISONS			FOOT-NOTES
						LARGEST HOLDING			SECOND LARGEST HOLDING						
FOUNDATION NAME	1/	AMOUNT ($000)	2/	TOTAL ($000)	2/	AMOUNT ($000)	2/	NAME	AMOUNT ($000)	2/	NAME	3/	4/	5/	
Dobson F Inc	n	2695	m	472	m	472	m	Maine National Bank	---	-	----------------	18	000	100	
Pew Jr, J N, Char T	n	121546	m	23845	b	21332	b	Sun Company Inc.	111	b	Weyerhaeuser Co.	18	000	89	
Kuntz F	n	1864	m	1218	m	318	b	Peter Kuntz Company	136	b	P K Springfield Inc	17	7	26	
Tektronix Foundation	n	3672	m	2707	m	619	m	Tektronix Inc	256	m	General Tel Electronic	17	7	25	
Jaffe Fdn	n	1844	m	454	b	287	b	J & J Corrugated Box C	14	b	Grell Bros	16	1	63	
Chatlos Fdn Inc	n	41147	m	25221	m	6458	m	Sun Ray Homes Inc	1762	m	A T &T	16	4	26	
Mott, Charles S, F	n	386534	m	301072	m	63140	m	General Motors Corp.	39537	m	US Sugar Corp.	16	10	21	
Dunwalke, C & AD	n	8699	m	5416	m	1348	m	USA Foreign	568	m	USA Foreign	15	7	25	
Clark Foundation	n	123695	m	84628	m	18375	m	Mesa Petroleum	5110	m	Pan Handle Eastern	15	4	22	
Baird, Cameron, F	n	7085	m	6843	m	1079	m	First Empire State C.	832	m	Florida Gulf Realty T.	15	12	16	
Street, Gordon, Fdn	o	3844	m	525	m	525	b	North Amer Royalties	--	-	----------------	14	000	100	
Kardon, S & R, Fdn	n	2102	m	322	m	297	m	American Rag&Paper Ind	25	m	Industrial Holding	14	1	92	
Wegener, H & M, F	n	2284	m	461	m	325	m	Technology Fund Inc	68	m	Affiliated Funds Inc	14	3	70	
Kempner, H & E, Fund	n	8364	m	6538	m	1168	m	H Kempner Cert/Memo In	625	m	Sugarland Ind Grantors	14	7	18	
Kemper, E & C, Fdn	n	24938	m	18715	m	3383	m	Kansas City South Ind.	2039	m	Harris Bankcorp Inc	14	8	18	
Breidenthal, WJ & MB	n	1254	m	163	b	163	b	Commercial Natl Bank	-	-	----------------	13	000	100	
Nordson Foundation	n	22071	m	3175	b	2800	b	Nordson Corporation	31	b	Georgia Pacific Corp	13	000	88	
Tisch Foundation Inc	n	7722	m	2021	m	993	m	Commonwealth Edison	919	m	Laurel in The Pines Inc	13	12	49	
Polk Foundation	n	1763	m	901	m	238	m	Gateway Opt Inc Fund	218	m	Winters Natl Corp	13	12	26	
Westport fund	n	622	m	447	m	80	m	Woods Petroleum	78	m	First Natl Charter	13	13	18	
Ruan, John R, F Tr	n	3048	m	702	b	352	b	Ruan Inc	349	b	Intel Corp	12	11	50	

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		ASSET		CORPORATE STOCK									PERCENTAGE COMPARISONS			
						LARGEST HOLDING			SECOND LARGEST HOLDING							
FOUNDATION NAME	1/	AMOUNT ($000)	2/	TOTAL ($000)	2/	AMOUNT ($000)	2/	NAME	AMOUNT ($000)	2/	NAME		3/	4/	5/	FOOT-NOTES
Revson, Charles H, F	n	65207	m	29138	m	7696	m	Revlon Inc.	989	m	IBM		12	2	26	
Medina Foundation	n	17158	m	9567	m	2030	m	Weyerhaeuser Co	979	m	Univar Corp.		12	6	21	
Rosemary Found.	n	14607	m	12566	m	1715	m	Delta Air Lines	909	m	Merrill Lynch R A Tr.		12	6	14	
Kohl, Dolores, E F	o	2073	m	240	b	276	b	American Tel & Tel	13	b	Templeton Energy Co		11	1	94	
Gloeckner, F C, F Inc	n	849	m	321	m	95	m	F C Gloeckner & Co Inc	22	m	A T & T		11	3	30	
Blanck, M & J, Fund F	n	4089	m	2137	m	456	m	Triple A Properties In	312	m	Union Pacific Corp		11	8	21	
Cuneo F	n	2037	m	1509	m	224		Tri Continental Corp	177	m	U S and Foreign Sec		11	9	15	
Leidesdorf Foundation	n	1062	m	770	m	112	m	Atlantic Richfield	100	m	Rio Verde Energy		11	5	15	
Presto Foundation	n	8717	m	1046	b	835	b	Natl Presto Inds Inc	37	b	Anglo American Gold		10	000	80	
Ordean Foundation	n	11801	m	5028	m	1237	m	St Mary Parish Land	380	m	Northwest Bancorp		10	3	25	
Watson, JJ & EJ, Fdn	n	9788	m	5085	m	1015	m	Summit Bank Corp	482	m	Mobil Corp		10	5	17	
Mellon, Andrew, Fdn	n	816855	m	537445	m	84504	m	Gulf Oil Corp.	19943	m	Aluminum Co of America		10	2	16	
Joseloff, Morris	n	4067	m	3630	m	412	m	Sycamore Corp/America	400	m	Culbro Corp.		10	10	11	
Western New York Fdn	n	3834	m	3531	m	367	m	Texas Oil Gas Corp	224	m	Quanex Corp		10	6	10	
Belz Foundation	n	1920	m	400	m	170	m	Belz Invest Co Inc	85	m	Servico Inc		9	4	43	
McCoy Fdn	n	1624	m	396	m	142	m	Natomas Corp	60	m	IT&T		9	4	36	
Fuller F Inc	n	2790	m	1001	m	237	m	Archer-Daniels-Midland	68	m	Smith International		9	2	24	
Guggenheim, D & F	n	5325	m	2558	m	478	m	I B M	484	m	Anglo Energy Ltd		9	9	19	
Susman, Asher, F	n	1978	m	1188	m	185	m	Kerr McGee	130	m	Baxter Travenol		9	7	16	
Bothin Helping Fdn	n	10077	m	6963	m	945	m	Standard Oil of CA	520	m	Exxon Corp.		9	5	14	
Mean, R John, Fdn	n	15442	m	10798	m	1316	m	Cleveland-Cliffs Iron C	869	m	Consolid/Natural Gas		9	6	12	

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		ASSET		CORPORATE STOCK								PERCENTAGE COMPARISONS			
						LARGEST HOLDING			SECOND LARGEST HOLDING						
FOUNDATION NAME	1/	AMOUNT ($000)	2/	TOTAL ($000)	2/	AMOUNT ($000)	2/	NAME	AMOUNT ($000)	2/	NAME	3/	4/	5/	FOOT-NOTES
Finley, A E, Fdn	n	3293	a	631	b	248	b	AE Finaly&Assoc of VA.	88	b	Duke Power Co.	8	3	39	
Stackpole Fdn	n	2189	a	3064	a	744	a	Penn Bank Corp	210	a	I B M	8	2	24	
J D B Fund	n	10549	a	5046	b	893	b	Temporary Invest Fund	356	b	Burrough Corp.	8	3	18	
Taylor, R & V, Fdn	n	19854	a	10366	a	1504	a	Placer Develop LTD	1101	a	Standard Oil of Ind.	8	000	15	
Reynolds, C, F	n	9406	a	3390	a	640	a	R J Reynolds Ind	414	a	U S Fidelity & Guar	7	4	19	
McMillian Jr, Bruce, F	n	8432	a	3542	a	551	a	Marathon Oil Co.	221	a	AT&T	7	3	16	
Crary, Bruce L, Fdn	n	2661	a	1307	a	184	a	Essex Co Chmp, N Bk	66	a	IBM	7	2	12	
Freeman, Ella West, F	n	12177	a	8079	a	885	a	Delta Airlines	521	a	Perkin Elmer	7	4	11	
Metcalf, Stanley W, F	n	2350	a	2049	a	162	a	So Natural Res	156	a	Philip Morris	7	7	8	
Sico Foundation	n	8400	a	492	b	492	b	Sico Co	----	-	---------------	6	000	100	
Rippel, F E, Fdn	n	32513	a	9372	a	2006	a	Fidelity Union Bankcor.	1730	a	First Natl State Bank	6	5	21	
Joslin-Needham Family	n	1870	a	838	a	117	a	Missouri Pacific Corp	83	a	Union Pacific Corp	6	4	14	
Lyon, EM & ML, F	n	9382	a	4074	a	576	a	Lyons B Ranch Inc	406	a	Lyons Melody Ranch Inc	6	4	14	
Independence F	n	40565	a	19946	a	2610	a	Union Pacific Corp.	2343	a	Atlantic Richfield Co	6	6	13	
Murdock, M J, Char Fdn	n	126798	a	68686	a	7260	a	Tektronix, Inc.	2377	a	I B M	6	2	11	A
Clark, Edna M, F	n	210911	a	121829	a	12953	a	Avon Products	3263	a	I B M	6	2	11	A
Kunstadter, Albert, F	n	1764	a	1102	a	106	a	Eastman Kodak	83	a	Standard Oil Ohio	6	5	10	
Richardson, Sid W, F	n	108591	a	75126	a	6316	a	Texas Amer Bankshares	3700	a	A T & T	6	3	8	
Aldeen, Geo Char Tr	n	1717	a	231	b	89	b	Hamilton Bros.	43	b	The Stanley Works	5	3	39	
Saite, Fred B, F	n	3771	a	1184	b	193	b	Saite Furniture	48	b	Delta Airlines	5	1	16	
Skaggs, LJ & MC, F	n	9206	a	5537	a	454	a	Pepsico, Inc	359	a	McDonalds, Corp	5	4	8	

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		ASSET		CORPORATE STOCK									PERCENTAGE COMPARISONS			
						LARGEST HOLDING			SECOND LARGEST HOLDING							
FOUNDATION NAME	1/	AMOUNT ($000)	2/	TOTAL ($000)	2/	AMOUNT ($000)	2/	NAME	AMOUNT ($000)	2/	NAME		3/	4/	5/	FOOT-NOTES
Whitney, H H, Fdn	n	13896	m	7781	m	656	m	Exxon Corp.	562	m	I B M		5	4	8	A
Collins Foundation	n	29799	m	23149	m	1488	m	US Bankcorp	1138	m	Pacific Lumber Co		5	4	6	
Public Welfare F Inc	n	107648	m	10421	b	4029	b	Spartanburg Herald Jou.	2000	b	The Gadsden Times		4	2	39	
Glosser, David A, F	n	1908	m	212	m	79	m	M Glosser&Sons	30	m	Toledo Edison		4	2	37	
Northam Found	o	14929	m	1908	b	670	b	American General Ins.	214	b	Texas Com Bankshares		4	1	35	
Kiplinger Foundation	n	6603	m	1458	b	291	b	Kiplinger Wash Ed	1098	b	Xerox Corporation		4	17	20	
Walgreen Benefit Fund	n	6457	m	1640	m	286	m	AT&T	116	m	Kimberly Clark WRP		4	2	17	
Aron, J, Char Fdn	n	17119	m	6322	m	692	m	Zapata	351	m	Nalco Chemical Co.		4	2	11	
Lang, Eugene M, F	n	8469	m	3747	m	300	m	V F Corporation	337	m	Pinkerton		4	4	10	
Davenport M F	n	4930	m	1084	b	180	b	F. Nat Bank of Malden	144	b	American Tel & Tel Co		4	3	10	
Hyde, L B, Fdn	n	16924	m	7574	m	752	m	Summit Bancorporation	520	m	Standard Oil of Ind.		4	3	10	
Hanes, JWH & AH, Fdn	n	6193	m	2597	m	241	m	Atlantic Richfield Co	231	m	Exxon Corp		4	4	9	
Honeywell F Inc	n	10040	m	3462	m	412	m	Capital Cities Com	410	m	Warner Com Inc		4	4	8	
Krannert Charitable T	n	57139	m	28015	b	2312	b	Time Inc.	1104	b	Indiana Natl Corp.		4	2	8	
Goldman, Herman, F	n	17320	m	10278	m	618	m	I B M	611	m	Chase Manhattan Corp.		4	4	6	
Ford Foundation	n	2365371	m	1691920	m	90856	m	A T & T .	89475	m	Exxon Corp.		4	3	5	A
Truland Foundation	n	1554	m	59	m	51	m	Potomac Electric Power	7	m	Alcan Aluminum Ltd		3	000	86	
Brenner, Fred J, F	n	2997	m	895	m	97	m	Wells Fargo Exp	89	m	No Cal Sav & Loan		3	3	11	
Swig Fdn	n	8491	m	2347	m	240	m	Metromedia	115	m	I B M		3	1	10	
Fair, R W, Fdn	n	13056	m	3930	b	400	b	A T & T	194	b	Howell Petroleum		3	1	10	

ATTACHMENT IV

LIST OF PRIVATE FOUNDATIONS REPORTING ASSETS IN EXCESS OF $1 MILLION AND REPORTING A 2 PERCENT OR MORE OWNERSHIP IN A FOR-PROFIT BUSINESS RANKED BY THE FOUNDATION'S LARGEST STOCK HOLDING AS A PERCENTAGE OF FAIR MARKET VALUE OF ITS ASSETS

		ASSET		CORPORATE STOCK								PERCENTAGE COMPARISONS			
						LARGEST HOLDING			SECOND LARGEST HOLDING						
FOUNDATION NAME	1/	AMOUNT ($000)	2/	TOTAL ($000)	2/	AMOUNT ($000)	2/	NAME	AMOUNT ($000)	2/	NAME	3/	4/	5/	FOOT-NOTES
Abrams, L & A, Fdn	n	13578	m	11970	m	373	m	29 East 64th St Corp	275	m	First Commerce Corp	3	2	3	
Rose, Billy, Fdn	n	10027	m	4203	m	350	m	Texas Oil & Gas	339	m	Merck & Co Inc.	3	3	8	
Kellogg, W K, Fdn	n	49648	m	34012	m	1534	m	I B M	1467	m	Marathon Oil Co.	3	3	5	
Wehr, Todd, Fdn	n	5596	m	3513	m	166	m	Combustion Engineering	156	m	Standard Oil of Ind	3	3	5	
Nationwide F	n	10143	m	6174	m	501	m	A T & T	281	m	Exxon Corp	3	3	5	
Oxford Foundation Inc	n	2325	m	1636	m	67	m	Penn Fuel Gas, Inc	177	m	Penn Enterprise, Inc	3	8	4	
Carpenter Foundation	n	4961	m	3667	m	157	m	IBM	140	m	Time Inc	3	3	4	
Odell, RS & HP, Fund	n	10867	m	7925	m	275	m	I B M	264	m	Allied Prop Liquid Tr.	3	2	3	
Russel, Tom, C Fdn	n	1093	m	23	b	23	b	Combined Insurance Co	---	-	------------------	2	000	100	
College F Inc	n	8778	m	161	b	160	b	Bus Dev Corp of N C	-	b	Bus Dev Corp of S C	2	000	99	
Perry, NG BD, Fdn	o	2556	m	123	b	43	b	Pugnticitas Oil Co	35	b	St Natl B Robstown	2	1	35	
Mebee, JE & LE, Fdn	n ·	301688	m	22662	b	6626	b	McGee Petroleum	1181	b	Pennzoil	2	000	29	
Pickford, Mary, Fdn	n	8710	m	748	m	142	m	American Home Products	125	m	Proctor Gamble Co	2	1	19	
Coleman F Inc	n	43125	m	8374	b	779	b	Pennzoil Co	674	b	First Chicago Corp	2	2	9	
Gulbenkian, Calouste, F	n	646530	m	196298	m	15976	b	Sacor Corp In Portugal	8821	b	I B M	2	1	8	
Benton Foundation	n	8480	m	2451	m	206	m	Time Inc	151	m	Archer Daniels	2	2	8	
Ferguson, Alice, F	o	1744	m	567	b	43	b	Avon Products	28	b	Alexander&Alexander	2	2	8	
Morgan Tr, CH RE & ED	n	3445	m	1036	m	75	m	MCI Communications Cor	48	m	Avet Inc	2	1	7	
Andrew, Aileen S, F	n	19476	m	7187	b	435	b	. Andrew Corporation	345	b	Philip Morris	2	2	6	
Hanson, Dane G, F	n	15862	m	6046	b	282	b	A T & T Co.	228	b	Kansas Power&Light Co.	2	1	5	
Fish, Ray C, Fdn	n	11134	m	4179	m	222	m	M&T Mortgage Inves Inc	165	m	MGIC Investment Corp.	2	1	5	

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LIST OF PRIVATE FOUNDATIONS REPORTING ASSETS IN EXCESS OF $1 MILLION AND REPORTING A 2 PERCENT OR MORE OWNERSHIP IN A FOR-PROFIT BUSINESS RANKED BY THE FOUNDATION'S LARGEST STOCK HOLDING AS A PERCENTAGE OF FAIR MARKET VALUE OF ITS ASSETS

				CORPORATE STOCK								PERCENTAGE COMPARISONS			
						LARGEST HOLDING			SECOND LARGEST HOLDING						
FOUNDATION NAME	1/	ASSET AMOUNT ($000)	2/	TOTAL ($000)	2/	AMOUNT ($000)	2/	NAME	AMOUNT ($000)	2/	NAME	3/	4/	5/	FOOT-NOTES
McGraw Fdn	n	8446	m	3487	m	177	m	Warner Communications	176	m	Metromedia Inc	2	2	5	A
Harrington, D & S, F	n	55530	m	16818	m	881	m	A T &T	871	m	Grifford Hill	2	2	5	
Francis, Parker B, F	n	15961	m	8365	b	325	b	Manufact. Hanover Corp	322	b	Philip Morris Inc.	2	2	4	
Beasley, T & R, Fdn	n	5767	m	40	b	40	b	Systemic Realty	---	-	------------------	1	000	100	A
Klein, M J, Fund	n	1263	m	15	m	15	m	Klein Properties Inc	---	-	------------------	1	000	100	
Stehlin Fdn-Cancer Re	n	2422	m	38	b	25	b	Romiac	3	b	Galveston-Houston	1	000	66	
Chiles Foundation	n	26133	m	1384	m	226	m	Chase Manhattan Corp	224	m	Bally Manufac Corp	1	1	59	A
Pritzker Foundation	n	7669	m	239	m	115	m	Rockwood & Co	1	m	Prairie Shores Inc	1	000	48	
White, G R, Tr	n	10914	m	277	m	65	m	Standard Oil Co of CA	24	m	Exxon Corporation	1	000	23	
Abercrombie, J S, F	n	10223	m	757	b	121	b	Texaco Inc	188	b	General Motors	1	2	16	
Loyola Fdn Inc	n	10474	m	546	b	110	b	IBM	62	b	Capital Properties	1	1	20	
Payne, FE & SB, F	n	31181	m	2971	m	183	m	Continental Ill Corp	121	m	I B M	1	000	6	
Eros, Polk, F Inc	n	10457	m	2330	m	134	m	Walbolt Stores	114	m	Outboard Marine	1	1	6	
Collins, Carr P, F	n	14949	m	3036	m	142	m	I B M	125	m	Exxon Corp	1	1	5	
Strauss, A & L, F Inc	n	23114	m	4587	m	220	m	Chieftan Dev Co Ltd	160	m	Brunswick Corp	1	1	5	
Moore Foundation	n	13107	m	3831	b	187	b	I B M Corp	146	b	Merck & Co	1	1	5	
Piper, M Stevens, Fdn	n	12621	m	3235	m	124	m	Eastman Kodak Co	109	m	Republic of Texas Corp	1	1	4	
Proctor, John C, End	o	30843	m	101	b	87	b	First Natl Bank/Peoria	13	b	Caprle Water Works	000	000	86	
Fikes, Leland, Fdn	n	35923	m	63	b	33	b	Arribe Oil Corp.	28	b	Foundation Land Co.	000	000	52	
McShain, John, Char	n	32748	m	327	b	106	b	Kent Moore Corp.	64	b	I N A	000	000	32	
Weingart Foundation	n	186274	m	8907	m	657	m	American Home Product	520	m	I B M	000	000	7	

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LIST OF PRIVATE FOUNDATIONS REPORTING ASSETS IN EXCESS OF $1 MILLION AND REPORTING A 2 PERCENT OR MORE OWNERSHIP IN A FOR-PROFIT BUSINESS RANKED BY THE FOUNDATION'S LARGEST STOCK HOLDING AS A PERCENTAGE OF FAIR MARKET VALUE OF ITS ASSETS

		ASSET		CORPORATE STOCK								PERCENTAGE COMPARISONS			
						LARGEST HOLDING			SECOND LARGEST HOLDING						
FOUNDATION NAME	1/	AMOUNT ($000)	2/	TOTAL ($000)	2/	AMOUNT ($000)	2/	NAME	AMOUNT ($000)	2/	NAME	3/	4/	5/	FOOT-NOTES
Cities Service F	n	7602	m	---	m	---	-	Community Traction C	---	-	-------------	000	000	000	E
System Development F	n	66757	m	---	-	---	-	----------------	---	-	-------------	000	000	000	B
Dietrich Bro Amer Corp	o	15865	m	51	m	51	m	The Dietrich Corp	---	-	-------------	000	000	100	
Public Art Fund Inc	o	1088	m	1	b	1	h	Chatham Realty Corp	---	-	-------------	000	000	100	A
Abell-Hanger F	n	28021	m	40	b	40	b	Grapeland Corp	---	-	-------------	000	000	100	
Annenberg Fund	n	31898	m	---	-	---	-	----------------	---	-	-------------	000	000	000	F
Parsons, Ralph M, F	n	71726	m	56588	m	---	-	----------------	---	-	-------------	000	000	000	G
Jinks, R T, Fdn	m	----	-	---	-	List of stock was not submitted						000	000	000	B
Goedde Foundation	m	----	-	---	-	List of stock was not submitted						000	000	000	B
Morris, KT & EL, F	n	50662	m	---	-	List of stock was not submitted						000	000	000	B
Welsh, Robert A, Fdn	o	149979	m	---	-	List of stock was not submitted						000	000	000	B
Kleberg, RJ & HC, Fdn	n	30401	m	5597	m	List of stock was not submitted						000	000	000	B,H
Connelly Foundation	n	56171	m	---	-	List of stock was not submitted						000	000	000	B
Sand Springs Home	o	32143	m	9332	h	List of stock was not submitted						000	000	000	B
Birks Family F	o	10341	m	1066	m	List of stock was not submitted						000	000	000	A,B
Crane Fund	n	35081	m	---	-	List of stock was not submitted						000	000	000	B
Cowell, S H, Fdn	n	76113	m	---	-	List of stock was not submitted						000	000	000	B
Andersen Foundation	n	26509	m	---	-	List of stock was not submitted						000	000	000	B
Cameron, H & IC, F	n	19192	m	---	-	List of stock was not submitted						000	000	000	B
Seaver Institute	n	14477	m	---	-	List of stock was not submitted						000	000	000	B
Sherman Foundation	o	40577	m	---	-	List of stock was not submitted						000	000	000	B

LIST OF PRIVATE FOUNDATIONS REPORTING ASSETS IN EXCESS OF $1 MILLION AND REPORTING A 2 PERCENT OR MORE OWNERSHIP IN A FOR-PROFIT BUSINESS RANKED BY THE FOUNDATION'S LARGEST STOCK HOLDING AS A PERCENTAGE OF FAIR MARKET VALUE OF ITS ASSETS

				CORPORATE STOCK								PERCENTAGE			
		ASSET				LARGEST HOLDING			SECOND LARGEST HOLDING			COMPARISONS			FOOT-
FOUNDATION NAME	1/	AMOUNT ($000)	2/	TOTAL ($000)	2/	AMOUNT ($000)	2/	NAME	AMOUNT ($000)	2/	NAME	3/	4/	5/	NOTES
Young, I L, Fdn	n	6111	=					List of stock was not submitted				000	000		B
Haggar Found	n	11434	=					List of stock was not submitted				000	000		B
Mead, GW & EO, F	n	9668	=					List of stock was not submitted				000	000		B
Atkinson Foundation	n	12275	=					List of stock was not submitted				000	000		B
Titmus Foundation	n	4276	=					List of stock was not submitted				000	000		B
Werner, C & S, Fdn	n	5746	=					List of stock was not submitted				000	000		B
Bamberger, RE & JE, F	n	3492	=					List of stock was not sumbitted				000	000		B
Brotman F of CA	n	4074	=					List of stock was not submitted				000	000		B
Hornischleger F Inc	n	2655	=					List of stock was not submitted				000	000		B
Kathery & Reynon F	n	3287	=					List of stock was not submitted				000	000		B
Bentz Found	n	2577	=					List of stock was not submitted				000	000		B
Perini Memorial Fdn In	n	3090	=					List of stock was not submitted				000	000		A,B
Mathis Memorial Fdn	n	1967	=					List of stock was not submitted				000	000		B
Wolfson Family Fdn	n	2836	=					List of stock was not submitted				000	000		B
Sosland Fdn	n	2552	=					List of stock was not submitted				000	000		B
Hemsley, H B, Fdn	n	1608	=					Foundation did not own corporate stock				000	000		J
Mullan, TF & CL, Fdn	n	2764	=					List of stock was not submitted				000	000		B
Community E Inc	n	2825	=					List of stock was not submitted				000	000		B
Reynord Fdn Inc	n	4103	=					List of stock was not submitted				000	000		B

FOOTNOTES:

A. Fair market value shown on page 1 of the return is the same as the total assets in the balance sheet on page 2 of the return which typically report assets at book value.

B. Detailed list of corporate stock was not included in the return. The 990PF returns for 1980 and 1979 did not require that a list of corporate stock be submitted.

C. List of corporate stock was not included with return. Certified public accountant's report attached to financial statement indicates the foundation owns 6,386,386 shares of A.H. Ahmanson & Company with a market value of $87,748,753 at October 31, 1981. The foundation also holds a 99 percent nonvoting equity interest in Ahmanson, Inc. which owns 900,000 shares of common stock in H.F. Ahmanson & Company with a market value of $13,142,250 at October 31, 1981.

D. The foundation disposed of all the corporate stock during the year ending June 30, 1981.

E. The foundation owned 149,911 shares of 8 percent preferred stock of the Community Traction Company, but neither the cost or market value was shown.

F. Foundation sold the corporate stock during the year taking a note payable in annual installments plus cash.

G. List of stock was incomplete. Only $6.9 million of the $30,988,000 was listed in detail.

H. List of stock was incomplete. Only $3.3 million of the $5.5 million was listed in detail.

I. The foundation reduced the fair market value of the total assets by about 10 percent of the value of its holding of Gannett, Inc. for blockage.

J. The foundation did not own any corporate stock.

K. Some stocks were not shown at market.

L. Details of $1,699,498 in stock was not submitted.

SOURCE: GAO analysis of data obtained from microfiche copies of tax returns, form 990PF, furnished in December 1982 by the Internal Revenue Service for the most recent available year filed by private foundations with assets of more than $1 million.

SUMMARY OF ASSETS HELD BY PRIVATE FOUNDATIONS REPORTING A 2 PERCENT OR MORE OWNERSHIP IN A FOR-PROFIT BUSINESS CLASSIFIED BY LARGEST STOCK HOLDING AS A PERCENTAGE OF FAIR MARKET VALUE OF ASSETS

Largest Stock Holding As a Percentage of Total Fair Market Value of Assets	Total Fair Market Value of Assets ($000)	%	Corporate Stock Held: Total ($000)	%	Corporate Stock Held: Largest Holding ($000)	%	Number of Foundations	%
100% +	1,008,495	5.2	1,068,390	8.2	1,063,994	12.8	13	3.6
95% to 99%	442,052	2.3	433,961	3.3	432,576	5.2	14	3.8
75% to 94%	4,539,435	23.3	3,888,082	29.9	3,730,933	44.9	45	12.3
50% to 74%	2,664,114	13.7	2,193,997	16.9	1,759,422	21.2	44	12.1
25% to 49%	2,071,618	10.6	1,263,484	9.7	734,756	8.8	64	17.5
3% to 24%	6,310,995	32.3	3,847,102	29.6	559,079	6.7	111	30.4
Less than 2%	1,737,973	8.9	311,279	2.4	29,077	.4	39	10.7
List of Stock Not Available	730,088	3.7					35	9.6
Total	19,504,770	100.0	13,006,295	100.0	8,309,839	100.0	365	100.0

SOURCE: GAO analysis of data obtained from microfiche copies of tax returns, form 990PF, furnished in December 1982 by the Internal Revenue Service for the most recent available year filed by private foundations with assets of more than $1 million.

ANALYSIS OF FOUNDATIONS EARNINGS RETURN RATE

ACCORDING TO FOUNDATION ASSET SIZE AT BOOK VALUE EXCLUDING THOSE ASSETS

REPORTED AS BEING HELD TO DIRECTLY CARRY OUT CHARITABLE PURPOSES

(NOTE A)

	NUMBER AND PERCENTAGE OF FOUNDATIONS BY ASSET SIZE AT BOOK VALUE						
RATE OF RETURN EARNED	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
ASSETS 0 OR NOT REPORTED	1,281	0	0	0	0	0	1,281
% OF TOTAL FOUNDATIONS	100	0	0	0	0	0	5
-19 % OR LESS	0	0	0	0	0	0	0
% OF TOTAL FOUNDATIONS	0	0	0	0	0	0	0
-9 TO -18 %	0	0	0	0	0	0	0
% OF TOTAL FOUNDATIONS	0	0	0	0	0	0	0
-1 TO -8 %	0	0	0	0	0	0	0
% OF TOTAL FOUNDATIONS	0	0	0	0	0	0	0
0 TO 1 %	0	4,124	713	579	125	29	5,570
% OF TOTAL FOUNDATIONS	0	47	12	7	4	6	20
2 TO 4 %	0	1,314	959	910	248	32	3,464
% OF TOTAL FOUNDATIONS	0	15	16	11	8	7	12
3 TO 6 %	0	1,200	1,471	2,379	754	123	5,927
% OF TOTAL FOUNDATIONS	0	14	25	28	26	25	21
7 TO 8 %	0	880	1,666	2,913	1,139	191	6,789
% OF TOTAL FOUNDATIONS	0	10	28	34	39	40	24
9 TO 10 %	0	349	555	1,019	344	60	2,327
% OF TOTAL FOUNDATIONS	0	4	9	12	12	12	8
11 TO 13 %	0	191	268	445	151	25	1,080
% OF TOTAL FOUNDATIONS	0	2	5	5	5	5	4
14 TO 18 %	0	109	145	165	78	13	510
% OF TOTAL FOUNDATIONS	0	1	2	2	3	3	2
19 AND OVER %	0	571	166	194	92	10	1,033
% OF TOTAL FOUNDATIONS	0	7	3	2	3	2	4
TOTAL NUMBER OF FOUNDATIONS	1,281	8,740	5,943	8,604	2,930	483	27,980

NOTE A: EARNINGS RETURN RATE WAS COMPUTED BY DIVIDING FOUNDATION ADJUSTED NET INCOME BY BOOK VALUE OF ASSETS EXCLUDING ASSETS REPORTED AS BEING HELD TO DIRECTLY CARRY OUT CHARITABLE PURPOSES.

SOURCE: GAO ANALYSIS OF IRS STATISTICS OF INCOME DIVISION RANDOM SAMPLE DATABASE OF 1979 PRIVATE FOUNDATION RETURNS. DATA REPRESENTS ESTIMATES PROJECTED TO THE UNIVERSE OF FOUNDATIONS.

ATTACHMENT VI

ANALYSIS OF FOUNDATIONS EARNINGS RETURN RATE

ACCORDING TO FOUNDATION ASSET SIZE AT FAIR MARKET VALUE OF ASSETS (NOTE A)

RATE OF RETURN EARNED	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
	------------NUMBER AND PERCENTAGE OF FOUNDATIONS BY ASSET SIZE AT FAIR MARKET VALUE----------						
ASSETS 0 OR NOT REPORTED	1,496	0	0	0	0	0	1,496
% OF TOTAL FOUNDATIONS	100	0	0	0	0	0	5
-19 % OR LESS	0	0	0	0	0	0	0
% OF TOTAL FOUNDATIONS	0	0	0	0	0	0	0
-9 TO -18 %	0	0	0	0	0	0	0
% OF TOTAL FOUNDATIONS	0	0	0	0	0	0	0
-1 TO -8 %	0	0	0	0	0	0	0
% OF TOTAL FOUNDATIONS	0	0	0	0	0	0	0
0 TO 1 %	0	3,876	700	724	203	46	5,548
% OF TOTAL FOUNDATIONS	0	46	12	8	6	8	20
2 TO 4 %	0	1,292	1,074	1,217	455	95	4,132
% OF TOTAL FOUNDATIONS	0	15	19	14	15	16	15
5 TO 6 %	0	1,143	1,429	2,529	1,038	215	6,354
% OF TOTAL FOUNDATIONS	0	14	25	29	33	36	23
7 TO 8 %	0	922	1,561	2,573	1,011	189	6,257
% OF TOTAL FOUNDATIONS	0	11	27	30	32	31	22
9 TO 10 %	0	288	600	995	246	39	2,167
% OF TOTAL FOUNDATIONS	0	3	10	12	8	7	8
11 TO 13 %	0	280	193	340	93	12	918
% OF TOTAL FOUNDATIONS	0	3	3	4	3	2	3
14 TO 18 %	0	72	82	129	34	4	321
% OF TOTAL FOUNDATIONS	0	1	1	1	1	1	1
19 AND OVER %	0	523	102	109	52	1	786
% OF TOTAL FOUNDATIONS	0	6	2	1	2	0	3
TOTAL NUMBER OF FOUNDATIONS	1,496	8,395	5,741	8,617	3,131	601	27,980

NOTE A: EARNINGS RETURN RATE WAS COMPUTED BY DIVIDING FOUNDATION ADJUSTED NET INCOME BY THE FAIR MARKET VALUE OF ASSETS.

SOURCE: GAO ANALYSIS OF IRS STATISTICS OF INCOME DIVISION RANDOM SAMPLE DATABASE OF 1979 PRIVATE FOUNDATION RETURNS. DATA REPRESENTS ESTIMATES PROJECTED TO THE UNIVERSE OF FOUNDATIONS.

ATTACHMENT VIII

ANALYSIS OF THE MIX OF ASSETS HELD ACCORDING TO FOUNDATION EARNINGS RETURN RATES

(NOTES A AND B)

DESCRIPTION OF ASSETS HELD	PERCENTAGE DISTRIBUTION OF FOUNDATION ASSETS BY EARNINGS RATES								
	LESS THAN 0	0	1	2 TO 4	5 TO 8	9 TO 13	14 TO 18	19 AND OVER	OVERALL
CASH	0	5	5	8	5	8	4	16	6
RECEIVABLES	0	2	3	4	1	3	9	3	2
INVENTORY	0	1	0	0	0	0	0	0	0
U.S.GOVERNMENT OBLIGATIONS	0	4	5	8	12	14	16	10	12
STATE AND LOCAL OBLIGATIONS	0	0	1	0	0	0	0	0	0
CORPORATE BONDS	0	29	5	13	21	24	13	10	21
CORPORATE STOCKS	0	33	37	43	50	36	49	48	46
MORTGAGE LOANS	0	1	0	5	1	1	1	1	1
DEPRECIABLE ASSETS-INVEST	0	2	2	1	0	1	1	1	1
LAND HELD FOR INVESTMENT	0	4	3	3	1	1	1	2	1
OTHER INVESTMENTS	0	3	16	5	7	7	5	7	7
OTHER ASSETS	0	16	22	8	2	2	0	1	3
OVERALL PERCENT	0	100	100	100	100	100	100	100	100

NOTE A: ASSETS ARE AT BOOK VALUE AND EXCLUDE ASSETS REPORTED AS BEING HELD TO DIRECTLY CARRY OUT CHARITABLE PURPOSES.

NOTE B: FOUNDATION EARNINGS RETRUN RATE WAS COMPUTED BY DIVIDING THE FOUNDATIONS ADJUSTED NET INCOME BY THE BOOK VALUE OF ASSETS EXCLUDING THOSE REPORTED AS BEING HELD TO DIRECTLY CARRY OUT CHARITABLE PURPOSES.

SOURCE: GAO ANALYSIS OF IRS STATISTICS OF INCOME DIVISION RANDOM SAMPLE DATABASE OF 1979 PRIVATE FOUNDATION RETURNS. DATA REPRESENTS ESTIMATES PROJECTED TO THE UNIVERSE OF FOUNDATIONS.

ATTACHMENT IX

ANALYSIS OF THE MIX OF ASSETS HELD ACCORDING TO FOUNDATION EARNINGS RETURN RATES

FOR FOUNDATIONS WITH ASSETS VALUED BETWEEN $1 AND $25,000

(NOTES A AND B)

DESCRIPTION OF ASSETS HELD	PERCENTAGE DISTRIBUTION OF FOUNDATION ASSETS BY EARNINGS RATES								
	LESS THAN 0	0	1	2 TO 4	5 TO 8	9 TO 13	14 TO 18	19 AND OVER	OVERALL
CASH	0	70	49	45	43	37	47	76	51
RECEIVABLES	0	8	0	3	1	2	9	1	3
INVENTORY	0	2	0	0	0	0	0	1	0
U.S.GOVERNMENT OBLIGATIONS	0	2	7	5	9	0	0	0	5
STATE AND LOCAL OBLIGATIONS	0	0	0	2	0	1	0	0	0
CORPORATE BONDS	0	2	0	6	13	19	0	4	8
CORPORATE STOCKS	0	8	34	26	26	29	37	12	22
MORTGAGE LOANS	0	0	0	0	1	0	0	0	0
DEPRECIABLE ASSETS-INVEST	0	0	0	0	0	0	0	0	0
LAND HELD FOR INVESTMENT	0	0	0	0	0	0	0	0	0
OTHER INVESTMENTS	0	2	9	14	7	5	0	1	7
OTHER ASSETS	0	6	0	0	0	7	7	6	2
OVERALL PERCENT	0	100	100	100	100	100	100	100	100

NOTE A: ASSETS ARE AT BOOK VALUE AND EXCLUDE ASSETS REPORTED AS BEING HELD TO DIRECTLY CARRY OUT CHARITABLE PURPOSES.

NOTE B: FOUNDATION EARNINGS RETRUN RATE WAS COMPUTED BY DIVIDING THE FOUNDATIONS ADJUSTED NET INCOME BY THE BOOK VALUE OF ASSETS EXCLUDING THOSE REPORTED AS BEING HELD TO DIRECTLY CARRY OUT CHARITABLE PURPOSES.

SOURCE: GAO ANALYSIS OF IRS STATISTICS OF INCOME DIVISION RANDOM SAMPLE DATABASE OF 1979 PRIVATE FOUNDATION RETURNS. DATA REPRESENTS ESTIMATES PROJECTED TO THE UNIVERSE OF FOUNDATIONS.

ANALYSIS OF THE MIX OF ASSETS HELD ACCORDING TO FOUNDATION EARNINGS RETURN RATES

FOR FOUNDATIONS WITH ASSETS VALUED BETWEEN $25,000 AND $100,000

(NOTES A AND B)

DESCRIPTION OF ASSETS HELD	------------PERCENTAGE DISTRIBUTION OF FOUNDATION ASSETS BY EARNINGS RATES------------								
	LESS THAN 0	0	1	2 TO 4	5 TO 8	9 TO 13	14 TO 18	19 AND OVER	OVERALL
CASH	0	34	26	33	28	22	20	38	28
RECEIVABLES	0	10	5	4	2	4	4	2	3
INVENTORY	0	3	1	0	0	0	0	0	0
U.S.GOVERNMENT OBLIGATIONS	0	3	4	8	9	4	2	7	7
STATE AND LOCAL OBLIGATIONS	0	2	0	0	0	0	0	0	0
CORPORATE BONDS	0	6	8	11	16	18	15	8	14
CORPORATE STOCKS	0	19	34	32	31	36	48	33	31
MORTGAGE LOANS	0	2	0	1	1	3	0	0	2
DEPRECIABLE ASSETS-INVEST	0	0	0	0	0	0	0	3	0
LAND HELD FOR INVESTMENT	0	4	10	2	1	0	1	1	1
OTHER INVESTMENTS	0	5	3	5	10	10	8	4	8
OTHER ASSETS	0	12	8	3	1	3	4	4	3
OVERALL PERCENT	0	100	100	100	100	100	100	100	100

NOTE A: ASSETS ARE AT BOOK VALUE AND EXCLUDE ASSETS REPORTED AS BEING HELD TO DIRECTLY CARRY OUT CHARITABLE PURPOSES.

NOTE B: FOUNDATION EARNINGS RETRUN RATE WAS COMPUTED BY DIVIDING THE FOUNDATIONS ADJUSTED NET INCOME BY THE BOOK VALUE OF ASSETS EXCLUDING THOSE REPORTED AS BEING HELD TO DIRECTLY CARRY OUT CHARITABLE PURPOSES.

SOURCE: GAO ANALYSIS OF IRS STATISTICS OF INCOME DIVISION RANDOM SAMPLE DATABASE OF 1979 PRIVATE FOUNDATION RETURNS. DATA REPRESENTS ESTIMATES PROJECTED TO THE UNIVERSE OF FOUNDATIONS.

ANALYSIS OF THE MIX OF ASSETS HELD ACCORDING TO FOUNDATION EARNINGS RETURN RATES

FOR FOUNDATIONS WITH ASSETS VALUED BETWEEN $100,000 AND $1,000,000

(NOTES A AND B)

DESCRIPTION OF ASSETS HELD	PERCENTAGE DISTRIBUTION OF FOUNDATION ASSETS BY EARNINGS RATES								
	LESS THAN 0	0	1	2 TO 4	5 TO 8	9 TO 13	14 TO 18	19 AND OVER	OVERALL
CASH	0	14	19	20	13	21	21	22	16
RECEIVABLES	0	5	5	6	2	2	8	7	3
INVENTORY	0	3	2	0	0	0	0	1	0
U.S.GOVERNMENT OBLIGATIONS	0	5	6	7	12	12	7	8	11
STATE AND LOCAL OBLIGATIONS	0	0	1	0	0	0	0	1	0
CORPORATE BONDS	0	8	10	11	21	18	14	10	19
CORPORATE STOCKS	0	25	27	37	37	32	35	33	36
MORTGAGE LOANS	0	2	2	2	1	2	2	1	1
DEPRECIABLE ASSETS-INVEST	0	8	1	2	0	1	2	2	1
LAND HELD FOR INVESTMENT	0	9	2	4	1	1	4	3	2
OTHER INVESTMENTS	0	6	9	7	9	9	5	9	8
OTHER ASSETS	0	17	16	5	2	2	3	4	3
OVERALL PERCENT	0	100	100	100	100	100	100	100	100

NOTE A: ASSETS ARE AT BOOK VALUE AND EXCLUDE ASSETS REPORTED AS BEING HELD TO DIRECTLY CARRY OUT CHARITABLE PURPOSES.

NOTE B: FOUNDATION EARNINGS RETRUN RATE WAS COMPUTED BY DIVIDING THE FOUNDATIONS ADJUSTED NET INCOME BY THE BOOK VALUE OF ASSETS EXCLUDING THOSE REPORTED AS BEING HELD TO DIRECTLY CARRY OUT CHARITABLE PURPOSES.

SOURCE: GAO ANALYSIS OF IRS STATISTICS OF INCOME DIVISION RANDOM SAMPLE DATABASE OF 1979 PRIVATE FOUNDATION RETURNS. DATA REPRESENTS ESTIMATES PROJECTED TO THE UNIVERSE OF FOUNDATIONS.

ANALYSIS OF THE MIX OF ASSETS HELD ACCORDING TO FOUNDATION EARNINGS RETURN RATES FOR FOUNDATIONS WITH ASSETS VALUED BETWEEN $1,000,000 AND $10,000,000

(NOTES A AND B)

DESCRIPTION OF ASSETS HELD	PERCENTAGE DISTRIBUTION OF FOUNDATION ASSETS BY EARNINGS RATES: LESS THAN 0	0	1	2 TO 4	5 TO 8	9 TO 13	14 TO 18	19 AND OVER	OVERALL
CASH	0	4	7	8	6	12	12	17	8
RECEIVABLES	0	3	4	6	2	2	2	3	3
INVENTORY	0	2	0	0	0	0	0	1	0
U.S.GOVERNMENT OBLIGATIONS	0	8	7	8	15	14	13	14	14
STATE AND LOCAL OBLIGATIONS	0	0	3	0	0	0	1	1	0
CORPORATE BONDS	0	4	7	12	24	22	14	15	21
CORPORATE STOCKS	0	22	35	46	42	35	44	37	40
MORTGAGE LOANS	0	0	1	2	1	1	2	2	1
DEPRECIABLE ASSETS-INVEST	0	6	0	2	0	1	3	2	1
LAND HELD FOR INVESTMENT	0	7	4	4	1	1	2	3	2
OTHER INVESTMENTS	0	7	8	7	6	10	7	5	7
OTHER ASSETS	0	37	25	5	2	2	1	1	4
OVERALL PERCENT	0	100	100	100	100	100	100	100	100

NOTE A: ASSETS ARE AT BOOK VALUE AND EXCLUDE ASSETS REPORTED AS BEING HELD TO DIRECTLY CARRY OUT CHARITABLE PURPOSES.

NOTE B: FOUNDATION EARNINGS RETRUN RATE WAS COMPUTED BY DIVIDING THE FOUNDATIONS ADJUSTED NET INCOME BY THE BOOK VALUE OF ASSETS EXCLUDING THOSE REPORTED AS BEING HELD TO DIRECTLY CARRY OUT CHARITABLE PURPOSES.

SOURCE: GAO ANALYSIS OF IRS STATISTICS OF INCOME DIVISION RANDOM SAMPLE DATABASE OF 1979 PRIVATE FOUNDATION RETURNS. DATA REPRESENTS ESTIMATES PROJECTED TO THE UNIVERSE OF FOUNDATIONS.

ATTACHMENT XIII

ANALYSIS OF THE MIX OF ASSETS HELD ACCORDING TO FOUNDATION EARNINGS RETURN RATES FOR FOUNDATIONS WITH ASSETS VALUED AT $10,000,000 OR MORE

(NOTES A AND B)

DESCRIPTION OF ASSETS HELD	PERCENTAGE DISTRIBUTION OF FOUNDATION ASSETS BY EARNINGS RATES								
	LESS THAN 0	0	1	2 TO 4	5 TO 8	9 TO 13	14 TO 18	19 AND OVER	OVERALL
CASH	0	3	1	2	3	5	1	14	3
RECEIVABLES	0	2	3	2	1	3	12	3	2
INVENTORY	0	0	0	0	0	0	0	0	0
U.S.GOVERNMENT OBLIGATIONS	0	3	4	10	12	15	18	6	12
STATE AND LOCAL OBLIGATIONS	0	0	0	0	0	0	0	0	0
CORPORATE BONDS	0	37	3	16	20	26	13	6	21
CORPORATE STOCKS	0	36	40	45	55	38	52	62	50
MORTGAGE LOANS	0	2	0	9	1	2	0	0	1
DEPRECIABLE ASSETS-INVEST	0	0	3	0	0	2	1	1	1
LAND HELD FOR INVESTMENT	0	3	3	3	0	1	0	0	1
OTHER INVESTMENTS	0	2	21	2	7	6	4	9	6
OTHER ASSETS	0	12	23	11	1	2	0	0	3
OVERALL PERCENT	0	100	100	100	100	100	100	100	100

NOTE A: ASSETS ARE AT BOOK VALUE AND EXCLUDE ASSETS REPORTED AS BEING HELD TO DIRECTLY CARRY OUT CHARITABLE PURPOSES.

NOTE B: FOUNDATION EARNINGS RETRUN RATE WAS COMPUTED BY DIVIDING THE FOUNDATIONS ADJUSTED NET INCOME BY THE BOOK VALUE OF ASSETS EXCLUDING THOSE REPORTED AS BEING HELD TO DIRECTLY CARRY OUT CHARITABLE PURPOSES.

SOURCE: GAO ANALYSIS OF IRS STATISTICS OF INCOME DIVISION RANDOM SAMPLE DATABASE OF 1979 PRIVATE FOUNDATION RETURNS. DATA REPRESENTS ESTIMATES PROJECTED TO THE UNIVERSE OF FOUNDATIONS.

ANALYSIS OF PRIVATE FOUNDATION EXPENSES ACCORDING TO FOUNDATION ASSET SIZE AT BOOK VALUE

	FOUNDATION ASSET SIZE AT BOOK VALUE						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
TOTAL NUMBER OF FOUNDATIONS	1,223	8,557	5,967	8,717	3,026	490	27,980
COMPENSATION EXPENSE:							
OFFICERS							
CHARITABLE DISBURSEMENTS ($)	215,640	2,298,555	1,613,524	4,594,330	10,949,266	24,823,886	44,495,201
% OF TOTAL OFFICER COMP.	76	75	77	55	52	67	62
NUMBER OF FOUND.	37	307	513	1,362	934	307	3,461
% OF TOTAL FOUND.	3	4	9	16	31	63	12
OTHER OPERATIONS ($)	66,713	776,388	471,703	3,798,845	10,102,550	12,193,418	27,409,616
% OF TOTAL OFFICER COMP.	24	25	23	45	48	33	38
NUMBER OF FOUND.	27	614	773	1,826	1,040	295	4,576
% OF TOTAL FOUND.	2	7	13	21	34	60	16
TOTAL OFFICER COMPENSATION ($)	282,353	3,074,943	2,085,227	8,393,175	21,051,816	37,017,304	71,904,817
% OF TOTAL EXPENSES	2	3	2	2	2	2	2
NUMBER OF FOUND.	58	721	907	2,162	1,242	334	5,424
% OF TOTAL FOUND.	5	8	15	25	41	68	19
OTHER SALARIES							
CHARITABLE DISBURSEMENTS ($)	58,416	11,084,097	4,910,313	15,064,485	47,599,449	68,828,178	147,544,938
% OF TOTAL OTHER SALARIES	91	86	93	82	89	90	89
NUMBER OF FOUND.	16	200	176	599	644	267	1,901
% OF TOTAL FOUND.	1	2	3	7	21	54	7

ANALYSIS OF PRIVATE FOUNDATION EXPENSES ACCORDING TO FOUNDATION ASSET SIZE AT BOOK VALUE

	FOUNDATION ASSET SIZE AT BOOK VALUE						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
TOTAL NUMBER OF FOUNDATIONS	1,223	8,557	5,967	8,717	3,026	490	27,980
OTHER OPERATIONS ($)	5,752	1,803,579	387,321	3,298,752	6,017,261	7,499,979	19,012,644
% OF TOTAL OTHER SALARIES	9	14	7	18	11	10	11
NUMBER OF FOUND.	32	123	117	390	404	207	1,272
% OF TOTAL FOUND.	3	1	2	4	13	42	5
TOTAL OTHER SALARY ($)	64,169	12,887,676	5,297,633	18,363,237	53,616,710	76,328,157	166,557,582
% OF TOTAL EXPENSES	1	12	6	4	5	4	5
NUMBER OF FOUND.	47	261	250	787	766	281	2,392
% OF TOTAL FOUND.	4	3	4	9	25	57	9
PENSION PLAN							
CHARITABLE DISBURSEMENTS ($)	0	0	96,248	351,927	2,624,473	9,611,184	12,683,832
% OF TOTAL PENSION PLAN	0	0	100	92	92	90	91
NUMBER OF FOUND.	0	0	16	40	126	152	333
% OF TOTAL FOUND.	0	0	0	0	4	31	1
OTHER OPERATIONS ($)	0	0	0	30,611	229,227	1,061,762	1,321,601
% OF TOTAL PENSION PLAN	0	0	0	8	8	10	9
NUMBER OF FOUND.	0	0	0	24	62	112	198
% OF TOTAL FOUND.	0	0	0	0	2	23	1
TOTAL PENSION ($)	0	0	96,248	382,538	2,853,700	10,672,946	14,005,433
% OF TOTAL EXPENSES	0	0	0	0	0	1	0
NUMBER OF FOUND.	0	0	16	52	139	157	364
% OF TOTAL FOUND.	0	0	0	1	5	32	1

ANALYSIS OF PRIVATE FOUNDATION EXPENSES
ACCORDING TO FOUNDATION ASSET SIZE AT BOOK VALUE

	FOUNDATION ASSET SIZE AT BOOK VALUE						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
TOTAL NUMBER OF FOUNDATIONS	1,223	8,557	5,967	8,717	3,026	490	27,980
OTHER BENEFITS							
CHARITABLE DISBURSEMENTS ($)	0	1,059,703	291,110	625,877	2,312,941	10,939,238	15,228,869
% OF TOTAL OTHER BENEFITS	0	81	93	81	87	99	95
NUMBER OF FOUND.	0	107	32	109	224	161	634
% OF TOTAL FOUND.	0	1	1	1	7	33	2
OTHER OPERATIONS ($)	0	251,111	22,327	145,354	340,381	118,059	877,231
% OF TOTAL OTHER BENEFITS	0	19	7	19	13	1	5
NUMBER OF FOUND.	0	46	21	52	111	121	351
% OF TOTAL FOUND.	0	1	0	1	4	25	1
TOTAL OTHER BENEFITS ($)	0	1,310,813	313,437	771,232	2,653,322	11,057,297	16,106,100
% OF TOTAL EXPENSES	0	1	0	0	0	1	0
NUMBER OF FOUND.	0	138	37	124	247	165	711
% OF TOTAL FOUND.	0	2	1	1	8	34	3
TOTAL COMPENSATION EXPENSE							
CHARITABLE DISBURSEMENTS ($)	274,056	14,442,354	6,911,195	20,636,619	63,486,130	114,202,486	219,952,840
% OF TOTAL EXPENSES	2	13	8	5	6	6	6
NUMBER OF FOUND.	52	445	640	1,768	1,246	341	4,493
% OF TOTAL FOUND.	4	5	11	20	41	70	16

ANALYSIS OF PRIVATE FOUNDATION EXPENSES
ACCORDING TO FOUNDATION ASSET SIZE AT BOOK VALUE

	FOUNDATION ASSET SIZE AT BOOK VALUE						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
TOTAL NUMBER OF FOUNDATIONS	1,223	8,557	5,967	8,717	3,026	490	27,980
OTHER OPERATIONS ($)	72,465	2,831,077	881,350	7,273,562	16,689,419	20,873,218	48,621,092
% OF TOTAL EXPENSES	1	3	1	2	2	1	1
NUMBER OF FOUND.	42	691	853	2,086	1,234	324	5,230
% OF TOTAL FOUND.	3	8	14	24	41	66	19
TOTAL COMPENSATION ($)	346,521	17,273,432	7,792,545	27,910,181	80,175,549	135,075,704	268,573,932
% OF TOTAL EXP.	3	16	9	6	8	7	8
NUMBER OF FOUND.	88	890	1,098	2,670	1,581	369	6,697
% OF TOTAL FOUND.	7	10	18	31	52	75	24
PROFESSIONAL SERVICE EXPENSE:							
CHARITABLE DISBURSEMENTS ($)	282,075	1,990,405	1,568,897	5,290,442	8,692,111	12,420,882	30,244,812
% OF TOTAL PROF SVS	78	85	65	45	36	31	37
NUMBER OF FOUND.	126	1,476	1,586	2,831	1,447	378	7,844
% OF TOTAL FOUND.	10	17	27	32	48	77	28
OTHER OPERATIONS ($)	77,472	360,786	838,119	6,491,263	15,611,530	27,806,256	51,185,427
% OF TOTAL PROF SVS	22	15	35	55	64	69	63
NUMBER OF FOUND.	131	1,243	1,726	3,849	1,956	397	9,303
% OF TOTAL FOUND.	11	15	29	44	65	81	33
TOTAL PROF SVS ($)	359,547	2,351,192	2,407,016	11,781,705	24,303,641	40,227,138	81,430,239
% OF TOTAL EXP.	3	2	3	3	2	2	2
NUMBER OF FOUND.	223	2,320	2,773	5,181	2,295	434	13,226
% OF TOTAL FOUND.	18	27	46	59	76	89	47

ANALYSIS OF PRIVATE FOUNDATION EXPENSES ACCORDING TO FOUNDATION ASSET SIZE AT BOOK VALUE

	FOUNDATION ASSET SIZE AT BOOK VALUE						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
TOTAL NUMBER OF FOUNDATIONS	1,223	8,557	5,967	8,717	3,026	490	27,980
CONTRIBUTION EXPENSE:							
EXEMPT PURPOSE	13,361,057	75,504,823	66,088,609	360,390,302	766,046,928	1,500,625,503	2,782,017,222
% OF TOTAL CONTRIB.	139	99	100	102	99	99	99
NUMBER OF FOUND.	388	5,866	5,210	7,849	2,676	459	22,447
% OF TOTAL FOUND.	32	69	87	90	88	94	80
OTHER OPERATIONS ($)	-3,722,733	1,107,149	51,814	-5,341,647	9,468,663	17,419,088	18,982,334
% OF TOTAL CONTRIB.	-39	1	0	-2	1	1	1
NUMBER OF FOUND.	47	261	171	190	142	85	896
% OF TOTAL FOUND.	4	3	3	2	5	17	3
TOTAL CONTRIBUTIONS ($)	9,638,324	76,611,972	66,140,423	355,048,655	775,515,591	1,518,044,591	2,800,999,557
% OF TOTAL EXP.	78	70	76	80	77	81	79
NUMBER OF FOUND.	372	5,927	5,226	7,896	2,683	460	22,564
% OF TOTAL FOUND.	30	69	88	91	89	94	81
OTHER EXPENSES:							
INTEREST							
CHARITABLE DISBURSEMENTS ($)	0	42,535	79,208	463,051	1,935,611	4,566,364	7,086,769
% OF TOTAL OTHER EXPENSES	0	44	28	29	30	53	41
NUMBER OF FOUND.	0	107	133	212	100	23	576
% OF TOTAL FOUND.	0	1	2	2	3	5	2

ANALYSIS OF PRIVATE FOUNDATION EXPENSES
ACCORDING TO FOUNDATION ASSET SIZE AT BOOK VALUE

	FOUNDATION ASSET SIZE AT BOOK VALUE						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
TOTAL NUMBER OF FOUNDATIONS	1,223	8,557	5,967	8,717	3,026	490	27,980
OTHER OPERATIONS ($)	0	54,492	206,701	1,152,250	4,603,176	3,980,655	9,997,274
% OF INTEREST EXPENSE	0	56	72	71	70	47	59
NUMBER OF FOUND.	0	215	230	507	299	47	1,298
% OF TOTAL FOUND.	0	3	4	6	10	10	5
TOTAL INTEREST ($)	0	97,027	285,909	1,615,300	6,538,787	8,547,019	17,084,043
% OF TOTAL EXPENSES	0	0	0	0	1	0	0
NUMBER OF FOUND.	0	307	347	688	377	63	1,782
% OF TOTAL FOUND.	0	4	6	8	12	13	6
TAXES							
CHARITABLE DISBURSEMENTS ($)	28,584	799,090	451,449	1,812,937	5,140,338	5,496,747	13,729,145
% OF TOTAL TAXES	34	78	44	21	22	10	15
NUMBER OF FOUND.	82	1,381	1,093	1,507	803	220	5,087
% OF TOTAL FOUND.	7	16	18	17	27	45	18
OTHER OPERATIONS ($)	56,450	224,524	576,778	6,728,812	18,140,603	49,198,116	74,925,282
% OF TOTAL TAXES	66	22	56	79	78	90	85
NUMBER OF FOUND.	137	2,978	3,934	6,788	2,559	436	16,832
% OF TOTAL FOUND.	11	35	66	78	85	89	60
TOTAL TAXES ($)	85,033	1,023,615	1,028,226	8,541,749	23,280,941	54,694,863	88,654,427
% OF TOTAL EXPENSES	1	1	1	2	2	3	3
NUMBER OF FOUND.	203	4,206	4,755	7,707	2,825	457	20,153
% OF TOTAL FOUND.	17	49	80	88	93	93	72

ATTACHMENT XIV

ANALYSIS OF PRIVATE FOUNDATION EXPENSES ACCORDING TO FOUNDATION ASSET SIZE AT BOOK VALUE

	FOUNDATION ASSET SIZE AT BOOK VALUE						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
TOTAL NUMBER OF FOUNDATIONS	1,223	8,557	5,967	8,717	3,026	490	27,980
DEPRECIATION							
EXEMPT PURPOSE--N/A							
OTHER OPERATIONS ($)	61,400	183,079	739,435	3,546,714	10,948,845	11,753,251	27,232,725
NUMBER OF FOUND.	15	292	256	763	666	191	2,184
% OF TOTAL FOUND.	1	3	4	9	22	39	8
RENT							
CHARITABLE DISBURSEMENTS ($)	0	1,512,175	489,096	1,006,111	2,596,248	6,288,940	11,892,570
% OF TOTAL RENT	0	81	81	67	54	79	71
NUMBER OF FOUND.	0	184	175	280	351	197	1,187
% OF TOTAL FOUND.	0	2	3	3	12	40	4
OTHER OPERATIONS ($)	21,150	359,443	112,893	493,083	2,204,703	1,660,463	4,851,735
% OF TOTAL RENT	100	19	19	33	46	21	29
NUMBER OF FOUND.	36	159	107	278	319	168	1,067
% OF TOTAL FOUND.	3	2	2	3	11	34	4
TOTAL RENT ($)	21,150	1,871,617	601,989	1,499,194	4,800,951	7,949,403	16,744,305
% OF TOTAL EXPENSES	0	2	1	0	0	0	0
NUMBER OF FOUND.	36	312	250	448	455	215	1,716
% OF TOTAL FOUND.	3	4	4	5	15	44	6

ATTACHMENT XIV

ANALYSIS OF PRIVATE FOUNDATION EXPENSES
ACCORDING [illegible] FOUNDATION ASSET SIZE AT BOOK VALUE

	FOUNDATION ASSET SIZE AT BOOK VALUE						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
TOTAL NUMBER OF FOUNDATIONS	1,223	8,557	5,967	8,717	3,026	490	27,980
OTHER							
CHARITABLE DISBURSEMENTS ($)	1,509,816	8,544,536	6,969,498	24,823,052	62,793,044	76,097,631	180,737,577
% OF TOTAL OTHER	85	82	82	73	78	77	77
NUMBER OF FOUND.	152	3,563	2,897	4,641	1,939	409	13,622
% OF TOTAL FOUND.	12	42	49	53	65	83	49
OTHER OPERATIONS ($)	268,153	1,910,028	1,532,818	9,043,427	18,209,050	23,350,115	54,313,592
% OF TOTAL OTHER	15	18	18	27	22	23	23
NUMBER OF FOUND.	157	2,461	2,579	4,446	1,919	383	11,945
% OF TOTAL FOUND.	13	29	43	51	63	78	43
TOTAL OTHER ($)	1,777,969	10,454,565	8,502,315	33,866,480	81,002,094	99,447,746	235,051,169
% OF TOTAL EXPENSES	14	10	10	8	8	5	7
NUMBER OF FOUND.	306	5,579	4,878	7,533	2,782	467	21,545
% OF TOTAL FOUND.	25	65	82	86	92	95	77
TOTAL OTHER EXPENSES							
CHARITABLE DISB. ($)	1,538,400	10,898,336	7,989,251	28,105,151	72,465,241	92,449,682	213,446,061
% OF TOTAL EXPENSES	13	10	9	6	7	5	6
NUMBER OF FOUND.	183	3,916	3,100	4,877	2,037	415	14,528
% OF TOTAL FOUND.	15	46	52	56	67	85	52
OTHER OPERATIONS ($)	407,153	2,731,568	3,168,624	20,964,285	54,106,378	89,942,600	171,320,608
% OF TOTAL EXPENSES	3	2	4	5	5	5	5
NUMBER OF FOUND.	213	4,211	4,474	7,432	2,825	466	19,621
% OF TOTAL FOUND.	17	49	75	85	93	95	70

ANALYSIS OF PRIVATE FOUNDATION EXPENSES
ACCORDING TO FOUNDATION ASSET SIZE AT BOOK VALUE

	FOUNDATION ASSET SIZE AT BOOK VALUE						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
TOTAL NUMBER OF FOUNDATIONS	1,223	8,557	5,967	8,717	3,026	490	27,980
TOTAL OTHER EXP ($)	1,945,553	13,629,904	11,157,875	49,069,436	126,571,619	182,392,282	384,766,668
% OF TOTAL EXP.	16	12	13	11	13	10	11
NUMBER OF FOUND.	372	6,654	5,647	8,509	2,993	481	24,655
% OF TOTAL FOUND.	30	78	95	98	99	98	88
GRAND TOTAL ALL EXPENSES							
TOTAL CHARITABLE DISB. ($)	15,455,595	102,836,471	82,558,437	414,423,450	910,690,885	1,719,698,660	3,245,663,499
% OF TOTAL EXPENSES	126	94	94	93	90	92	92
NUMBER OF FOUND.	464	7,078	5,684	8,472	2,972	483	25,155
% OF TOTAL FOUND.	38	83	95	97	98	99	90
TOTAL OTHER OPERATIONS ($)	-3,165,587	7,031,087	4,940,710	29,389,316	95,876,789	156,041,195	290,113,511
% OF TOTAL EXPENSES	-26	6	6	7	10	8	8
NUMBER OF FOUND.	275	4,549	4,612	7,657	2,892	475	20,460
% OF TOTAL FOUND.	22	53	77	88	96	97	73
TOTAL EXPENSES ($)	12,290,008	109,867,559	87,499,147	443,812,767	1,006,567,675	1,875,739,855	3,535,777,010
NUMBER OF FOUND.	510	7,821	5,909	8,667	3,016	487	26,410
% OF TOTAL FOUND.	42	91	99	99	100	99	94

SOURCE: GAO ANALYSIS OF IRS STATISTICS OF INCOME DIVISION RANDOM SAMPLE DATABASE OF 1979 PRIVATE FOUNDATION RETURNS. DATA REPRESENTS ESTIMATES PROJECTED TO THE UNIVERSE OF FOUNDATIONS.

ATTACHMENT XV

ATTACHMENT XV

ANALYSIS OF THE RATE AT WHICH PRIVATE FOUNDATIONS MAKE DISBURSEMENTS FOR EXEMPT PURPOSE IN RELATIONSHIP TO THEIR TOTAL EXPENSES
(NOTE A)

1 OF 2

	NUMBER AND PERCENTAGE OF FOUNDATIONS BY SIZE OF TOTAL EXPENSES						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
EXPENSES 0 OR NOT REPORTED	1,570	0	0	0	0	0	1,570
% OF TOTAL FOUNDATIONS	100	0	0	0	0	0	6
RATE OF EXEMPT PURPOSE DISBURSEMENTS							
0	0	1,198	103	55	1	0	1,357
% OF TOTAL FOUNDATIONS	0	7	2	2	0	0	5
1 TO 9	0	173	15	4	3	0	196
% OF TOTAL FOUNDATIONS	0	1	0	0	1	0	1
10 TO 19	0	103	30	12	3	0	147
% OF TOTAL FOUNDATIONS	0	1	1	0	1	0	1
20 TO 29	0	76	25	13	3	1	118
% OF TOTAL FOUNDATIONS	0	0	0	0	1	3	0
30 TO 39	0	158	35	16	6	1	219
% OF TOTAL FOUNDATIONS	0	1	1	1	1	3	1
40 TO 49	0	190	38	37	7	0	273
% OF TOTAL FOUNDATIONS	0	1	1	1	1	0	1
50 TO 59	0	163	32	46	9	0	251
% OF TOTAL FOUNDATIONS	0	1	1	1	2	0	1
60 TO 69	0	309	104	58	12	1	484
% OF TOTAL FOUNDATIONS	0	2	2	2	2	3	2
70 TO 79	0	596	184	123	21	5	929
% OF TOTAL FOUNDATIONS	0	3	4	4	4	15	3
80 TO 89	0	2,006	714	475	61	2	3,258
% OF TOTAL FOUNDATIONS	0	12	14	14	11	6	12
90 TO 99	0	6,420	2,602	1,920	317	17	11,277
% OF TOTAL FOUNDATIONS	0	37	51	56		52	40
100	0	5,684	1,233	629	82	2	7,631
% OF TOTAL FOUNDATIONS	0	33	24	18	15	6	27
OVER 100	0	187	25	37	17	4	270
% OF TOTAL FOUNDATIONS	0	1	0	1	3	12	1
TOTAL NUMBER OF FOUNDATIONS	1,570	17,265	5,142	3,426	544	33	27,980

ATTACHMENT XV

ANALYSIS OF THE RATE AT WHICH PRIVATE FOUNDATIONS MAKE DISBURSEMENTS FOR EXEMPT PURPOSE IN RELATIONSHIP TO THEIR TOTAL EXPENSES

(NOTE A)

NOTE A: RATE OF EXEMPT PURPOSE DISBURSEMENTS WAS COMPUTED BY DIVIDING EACH FOUNDATION'S EXEMPT PURPOSE DISBURSEMENTS BY TOTAL EXPENSES.

SOURCE: GAO ANALYSIS OF IRS STATISTICS OF INCOME DIVISION RANDOM SAMPLE DATABASE OF 1979 PRIVATE FOUNDATION RETURNS. DATA REPRESENTS ESTIMATES PROJECTED TO THE UNIVERSE OF FOUNDATIONS.

ATTACHMENT XVI

ANALYSIS OF THE RATE AT WHICH PRIVATE FOUNDATIONS MAKE QUALIFYING DISTRIBUTIONS IN RELATIONSHIP TO THEIR TOTAL EXPENSES

(NOTE A)

	NUMBER AND PERCENTAGE OF FOUNDATIONS BY SIZE OF TOTAL EXPENSES						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
EXPENSES 0 OR NOT REPORTED	1,570	0	0	0	0	0	1,570
% OF TOTAL FOUNDATIONS	100	0	0	0	0	0	6
RATE OF QUALIFYING DISTRIBUTIONS							
0	0	1,147	100	48	1	0	1,297
% OF TOTAL FOUNDATIONS	0	7	2	1	0	0	5
1 TO 9	0	156	13	7	3	0	180
% OF TOTAL FOUNDATIONS	0	1	0	0	1	0	1
10 TO 19	0	76	18	10	2	0	105
% OF TOTAL FOUNDATIONS	0	0	0	0	0	0	0
20 TO 29	0	78	21	10	3	0	112
% OF TOTAL FOUNDATIONS	0	0	0	0	1	0	0
30 TO 39	0	169	43	19	5	0	235
% OF TOTAL FOUNDATIONS	0	1	1	1	1	0	1
40 TO 49	0	136	35	31	6	0	208
% OF TOTAL FOUNDATIONS	0	1	1	1	1	0	1
50 TO 59	0	152	32	39	9	0	233
% OF TOTAL FOUNDATIONS	0	1	1	1	2	0	1
60 TO 69	0	289	87	55	12	1	443
% OF TOTAL FOUNDATIONS	0	2	2	2	2	3	2
70 TO 79	0	557	186	112	17	3	876
% OF TOTAL FOUNDATIONS	0	3	4	3	3	9	3
80 TO 89	0	1,981	698	445	50	3	3,177
% OF TOTAL FOUNDATIONS	0	11	14	13	9	9	11
90 TO 99	0	6,366	2,544	1,857	313	19	11,100
% OF TOTAL FOUNDATIONS	0	37	49	54	58	58	40
100	0	5,580	1,224	607	80	2	7,493
% OF TOTAL FOUNDATIONS	0	32	24	18	15	6	27
OVER 100	0	579	140	185	42	5	951
% OF TOTAL FOUNDATIONS	0	3	3	5	8	15	3
TOTAL NUMBER OF FOUNDATIONS	1,570	17,265	5,142	3,426	544	33	27,980

NOTE A: RATE OF QUALIFYING DISTRIBTUTIONS WAS COMPUTED BY DIVIDING EACH FOUNDATION'S QUALIFYING DISTRIBUTIONS BY TOTAL EXPENSES.

SOURCE: GAO ANALYSIS OF IRS STATISTICS OF INCOME DIVISION RANDOM SAMPLE DATABASE OF 1979 PRIVATE FOUNDATION RETURNS. DATA REPRESENTS ESTIMATES PROJECTED TO THE UNIVERSE OF FOUNDATIONS.

ATTACHMENT XVII

ATTACHMENT XVII

1 OF 2

ANALYSIS OF THE RATE AT WHICH PRIVATE FOUNDATIONS MAKE DISBURSEMENTS FOR EXEMPT PURPOSES IN RELATIONSHIP TO THEIR ADJUSTED NET INCOME

(NOTE A)

	NUMBER AND PERCENT OF FOUNDATIONS BY SIZE OF ADJUSTED NET INCOME						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
TOTAL NUMBER OF FOUNDATIONS	5,792	15,752	3,744	2,320	346	25	27,980
REVENUE LESS THAN 0	0	0	0	0	0	0	0
% OF TOTAL FOUNDATIONS	0	0	0	0	0	0	0
REVENUES 0 OR NOT REPORTED	5,792	0	0	0	0	0	5,792
% OF TOTAL FOUNDATIONS	100	0	0	0	0	0	21
RATE OF EXEMPT PURPOSE DISBURSEMENT							
0 TO 9	0	1,894	94	46	3	0	1,238
% OF TOTAL FOUNDATIONS	0	7	3	2	1	0	4
10 TO 19	0	175	33	19	3	0	230
% OF TOTAL FOUNDATIONS	0	1	1	1	1	0	1
20 TO 29	0	175	56	30	2	1	264
% OF TOTAL FOUNDATIONS	0	1	2	1	1	4	1
30 TO 39	0	148	58	31	5	1	243
% OF TOTAL FOUNDATIONS	0	1	2	1	1	4	1
40 TO 49	0	252	76	50	7	0	385
% OF TOTAL FOUNDATIONS	0	2	2	2	2	0	1
50 TO 59	0	287	93	70	14	0	464
% OF TOTAL FOUNDATIONS	0	2	2	3	4	0	2
60 TO 69	0	506	169	131	18	2	827
% OF TOTAL FOUNDATIONS	0	3	5	6	5	8	3
70 TO 79	0	696	290	189	36	2	1,213
% OF TOTAL FOUNDATIONS	0	4	8	8	10	8	4
80 TO 89	0	880	382	307	65	9	1,643
% OF TOTAL FOUNDATIONS	0	6	10	13	19	36	6
90 TO 99	0	1,572	572	458	82	7	2,690
% OF TOTAL FOUNDATIONS	0	10	15	20	24	28	10
100 TO 109	0	1,285	460	242	34	2	2,023
% OF TOTAL FOUNDATIONS	0	8	12	10	10	8	7

ANALYSIS OF THE RATE AT WHICH PRIVATE FOUNDATIONS MAKE DISBURSEMENTS

FOR EXEMPT PURPOSES IN RELATIONSHIP TO THEIR ADJUSTED NET INCOME

(NOTE A)

2 OF 2

	NUMBER AND PERCENT OF FOUNDATIONS BY SIZE OF ADJUSTED NET INCOME						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
110 TO 119	0	658	228	145	14	0	1,045
% OF TOTAL FOUNDATIONS	0	4	6	6	4	0	4
120 TO 129	0	562	154	75	11	0	802
% OF TOTAL FOUNDATIONS	0	4	4	3	3	0	3
130 TO 139	0	424	115	51	6	0	596
% OF TOTAL FOUNDATIONS	0	3	3	2	2	0	2
140 TO 149	0	316	112	51	8	0	487
% OF TOTAL FOUNDATIONS	0	2	3	2	2	0	2
150 TO 199	0	1,178	241	145	16	0	1,579
% OF TOTAL FOUNDATIONS	0	7	6	6	5	0	6
200 TO 299	0	1,105	201	114	13	0	1,433
% OF TOTAL FOUNDATIONS	0	7	5	5	4	0	5
300 AND OVER	0	4,440	411	166	8	1	5,026
% OF TOTAL FOUNDATIONS	0	28	11	7	2	4	18
TOTAL NUMBER OF FOUNDATIONS	5,792	15,752	3,744	2,320	346	25	27,980

NOTE A: RATE OF EXEMPT PURPOSE DISBURSEMENTS WAS COMPUTED BY DIVIDING EACH FOUNDATION'S EXEMPT PURPOSE DISBURSEMENT BY ADJUSTED NET INCOME.

SOURCE: GAO ANALYSIS OF IRS STATISTICS OF INCOME DIVISION RANDOM SAMPLE DATABASE OF 1979 PRIVATE FOUNDATION RETURNS. DATA REPRESENTS ESTIMATES PROJECTED TO THE UNIVERSE OF FOUNDATIONS.

ATTACHMENT XVIII

ANALYSIS OF THE RATE AT WHICH PRIVATE FOUNDATIONS MAKE QUALIFYING DISTRIBUTIONS IN RELATIONSHIP TO THEIR ADJUSTED NET INCOME

(NOTE A)

	NUMBER AND PERCENT OF FOUNDATIONS BY SIZE OF AJUSTED NET INCOME						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
TOTAL NUMBER OF FOUNDATIONS	5,792	15,752	3,744	2,320	346	25	27,980
REVENUE LESS THAN 0	0	0	0	0	0	0	0
% OF TOTAL FOUNDATIONS	0	0	0	0	0	0	0
REVENUES 0 OR NOT REPORTED	5,792	0	0	0	0	0	5,792
% OF TOTAL FOUNDATIONS	100	0	0	0	0	0	21
RATE OF QUALIFYING DISTRIBUTIONS							
0 TO 9	0	1,048	81	38	2	0	1,169
% OF TOTAL FOUNDATIONS	0	7	2	2	1	0	4
10 TO 19	0	128	24	15	2	0	170
% OF TOTAL FOUNDATIONS	0	1	1	1	1	0	1
20 TO 29	0	141	52	28	1	0	222
% OF TOTAL FOUNDATIONS	0	1	1	1	0	0	1
30 TO 39	0	143	53	28	2	0	226
% OF TOTAL FOUNDATIONS	0	1	1	1	1	0	1
40 TO 49	0	249	74	42	8	0	373
% OF TOTAL FOUNDATIONS	0	2	2	2	2	0	1
50 TO 59	0	279	85	66	14	0	444
% OF TOTAL FOUNDATIONS	0	2	2	3	4	0	2
60 TO 69	0	503	160	119	19	2	804
% OF TOTAL FOUNDATIONS	0	3	4	5	6	8	3
70 TO 79	0	706	283	190	30	2	1,212
% OF TOTAL FOUNDATIONS	0	4	8	8	9	8	4
80 TO 89	0	871	381	297	66	7	1,623
% OF TOTAL FOUNDATIONS	0	6	10	13	19	28	6
90 TO 99	0	1,578	568	469	84	9	2,707
% OF TOTAL FOUNDATIONS	0	10	15	20	24	36	10
100 TO 109	0	1,303	472	255	36	2	2,068
% OF TOTAL FOUNDATIONS	0	8	13	11	10	8	7

ATTACHMENT XVIII

ANALYSIS OF THE RATE AT WHICH PRIVATE FOUNDATIONS MAKE QUALIFYING DISTRIBUTIONS IN RELATIONSHIP TO THEIR ADJUSTED NET INCOME
(NOTE A)

	NUMBER AND PERCENT OF FOUNDATIONS BY SIZE OF AJUSTED NET INCOME						
	0 OR NOT REPORTED	1 UNDER 25,000	25,000 UNDER 100,000	100,000 UNDER 1,000,000	1,000,000 UNDER 10,000,000	10,000,000 AND OVER	TOTAL
110 TO 119	0	681	238	146	13	1	1,078
% OF TOTAL FOUNDATIONS	0	4	6	6	4	4	4
120 TO 129	0	558	154	71	12	1	796
% OF TOTAL FOUNDATIONS	0	4	4	3	3	4	3
130 TO 139	0	426	120	48	8	0	602
% OF TOTAL FOUNDATIONS	0	3	3	2	2	0	2
140 TO 149	0	304	114	47	9	0	473
% OF TOTAL FOUNDATIONS	0	2	3	2	3	0	2
150 TO 199	0	1,181	248	153	16	0	1,599
% OF TOTAL FOUNDATIONS	0	7	7	7	5	0	6
200 TO 299	0	1,120	213	125	13	0	1,471
% OF TOTAL FOUNDATIONS	0	7	6	5	4	0	5
300 AND OVER	0	4,533	424	183	10	1	5,152
% OF TOTAL FOUNDATIONS	0	29	11	8	3	4	18
TOTAL NUMBER OF FOUNDATIONS	5,792	15,752	3,744	2,320	346	25	27,980

NOTE A: RATE OF QUALIFYING DISTRIBUTIONS WAS COMPUTED BY DIVIDING EACH FOUNDATION'S QUALIFYING DISTRIBUTIONS BY ADJUSTED NET INCOME.

SOURCE: GAO ANALYSIS OF IRS STATISTICS OF INCOME DIVISION RANDOM SAMPLE DATABASE OF 1979 PRIVATE FOUNDATION RETURNS. DATA REPRESENTS ESTIMATES PROJECTED TO THE UNIVERSE OF FOUNDATIONS.

U.S. GENERAL ACCOUNTING OFFICE
OBJECTIVES, SCOPE, AND METHODOLOGY FOR PROFILING PRIVATE FOUNDATIONS

As requested by the Chairman of the Subcommittee on Oversight, House Committee on Ways and Means, on March 11, 1983, our objectives were to determine

--the financial well-being of private foundations, as indicated by the rate of growth in their financial resources over the years, their major sources of revenues, the extent of their business holdings, and rate of return on their investments and business operations; and

--the degree to which private foundations use their financial resources for charitable purposes, as evidenced by the type of expenses they incur and the relationship between their expenditures for charitable purposes and their total expenses, as well as their earnings.

To develop information on the foundations' financial resources and charity-related expenditures, we analyzed an available IRS computer data base containing a sample of returns filed by private foundations for tax year 1979. This data base was the most recent and complete source of computerized data on private foundations available to us for analysis within the time frames for this hearing.

The data base was developed by IRS' Statistics of Income Division based on a sample of private foundation returns processed by IRS during 1980. The sample was stratified based on size of total foundation assets and selected at rates that ranged from 7 percent of foundations with assets of less than

$25,000 to 100 percent of foundations with assets of $10 million or over. There were 9,438 returns in the sample drawn from an estimated population of 29,845 private foundations. While we did not review IRS' methodology in detail, we did look briefly at the procedures IRS followed to sample, process, and analyze the data and found them to be generally sound. We also performed limited checks on the data to assess its reliability.

It should be recognized, that any data analysis effort which is based on a sample is subject to a certain amount of sampling error. The size of this error generally depends on the size of the sample and how much the data varies for any given element. Our limited analysis shows that even though IRS' sample sizes are relatively large, the data varies considerably. Therefore, the figures presented should not be considered precise, but rather indicators of the foundations' financial positions. On the other hand, because the sample size increased as book value of assets increased, greater reliability can be placed on the data for the larger foundations.

In analyzing the data base for presentation at these hearings, we prepared numerous schedules and charts which are reproduced in the preceding attachments. The following summarizes the purposes of those charts and where appropriate, the rationale used for selecting certain financial indicators to profile foundation activities, as opposed to other indicators.

--Attachment II is a summary income statement that we complied to show the sources of foundation revenues, as well as the number of foundations whose revenues exceeded expenses and the primary source of those revenues. For ease of presentation, we consolidated the revenue data reported on foundation returns into four categories--donation, passive income, business income, and other income. The donation category includes gross contributions gifts and grants received by the foundations, as well as dues and assessments. Passive income includes revenues from interest, dividends, rents, and royalties. Business income represents gross profits from business activities and other income includes net gain or loss from asset sales not included in business income and the category "other" income. The expense category was similarly consolidated. Attachment XIV contains the detailed line items from the foundation returns comprising the four general expense categories listed.

--Attachment III is a summary chart that we compiled to show the type of assets held by foundations at year end. Book value rather than market value was used to compile the schedule because the return only requires foundations to report this information based on the method the foundation uses in keeping its books and records. As with revenues and expenses we consolidated similar assets reported on foundation returns for ease of presentation. Savings and interest bearing accounts and other cash accounts were consolidated as were net accounts receivable and net notes receivable.

--Attachments VI and VII are summary charts that we compiled to measure the return foundations earned on their assets. The earnings measure we selected was adjusted net income. Generally speaking, adjusted net income, as defined by section 4942(f) of the Internal Revenue Code, is the amount by which a private foundation's revenue exceeds the expense of earning that revenue. We selected this measure because during 1979, the Code required most foundations to make certain charitable distributions in an amount at least equal to their adjusted net income less certain adjustments. On the asset side we used two measures for comparison. We used book value of assets because the value of depreciable assets and land held for charitable purposes could be identified on the return and eliminated from the computation. On the other hand, since the book value of assets may differ substantially from the market value of assets, we also computed the earnings return based on foundation total asset market values. To compute the return rate for each foundation, we divided their adjusted net income by their asset values at year end.

--Attachments VIII through XIII are a series of charts that we compiled to show whether differences in the type of assets held by private foundations affected the rate of return earned. The earnings return computations were based on asset book value at year end rather than market value because the foundation return instructions specify that the asset data is to be reported based on the method the foundation uses in keeping its books and records. As in attachment VI, we also excluded those assets which were identified as being held for charitable purposes to minimize the affect those assets may have had on the earnings return computation. The value of those assets are reported in attachment III. In computing the rate of return, we followed the same procedures used in compiling attachment VI. However, in addition to the overall chart in attachment VIII, we prepared five additional charts--attachments IX through XIII--to account for the various foundation sizes.

--Attachment XIV is a detailed breakdown of foundation expenses that we compiled to show the type expenses incurred and extent to which these expenses were reported as disbursements for exempt--charitable--purposes. Charitable disbursements are defined by IRS to include gifts, grants, and contributions made to public charities and all necessary and reasonable administrative expenses paid by the foundation for religious, charitable, scientific, literary, educational, or other public purposes. We selected charitable disbursements as a measure of the foundations' charitable activities because of the broad nature of the measure and the fact that it could be applied to foundations regardless of the method of their operation. Some foundations make grants to others to carry out charitable activities, some directly carry out charitable activities, and some do both. Therefore, only considering grants made by foundations would not account for much of their activities. Also, charitable purpose disbursements is the only measure reported on foundation returns that can be related to the various kinds of foundation expenses. However, as with any measure, it is not without some drawbacks. Some foundations might have been applying more of their expenses to charitable purposes than was reported as exempt purpose disbursements. To the extent that a foundation's charitable activities produce revenues, such as charging for services provided to the public or operating a museum which charges admission, the foundation is required by IRS to report the associated expenses--up to the level of revenue earned--as an expense for computing adjusted net income. Foundations are instructed not to classify those expenses as disbursements for exempt purposes. Accordingly, the data base analyzed does not permit an analysis of this type of situation, nor does any other historical data maintained by IRS.

--Attachment XV is a chart that we compiled to show the extent to which private foundations make charitable purpose disbursements in relation to their total expenses. This attachment, which supplements the overall data reported in attachment XIV, ranks the foundations according to their disbursements for exempt purposes as a percentage of their total expenses.

--Attachment XVI is similar to attachment XV in that it ranks foundations according to the degree to which they engage in charitable activities, however, it was compiled based on a different measure of charitable activity--distributions qualifying as charitable expenditures under the Internal Revenue Code's minimum payout provision. In general, such qualifying distributions as defined in Section 4942(g) of the Internal Revenue Code include the charitable purpose disbursements previously described, plus amounts paid for program related investments, amounts paid to acquire assets used directly to carry out charitable purposes, and amounts set aside for specific charitable purpose projects. These latter amounts would generally not be fully recognized by the foundation as expenses during the year. As with exempt purpose disbursements, measuring foundation charitable activities by their qualifying distributions also has some drawbacks. Certain foundations may be reporting information on their returns which would indicate their qualifying distributions were quite small in relationship to their total expenses yet be using essentially all of their assets in furtherance of exempt purposes. Furthermore, as with the disbursements for exempt purposes, the data represents one year disbursement and distribution statistics, and may not be indicative of the multi-year spending patterns of the foundations. For tax year 1979, the Internal Revenue Code required most foundations to make qualifying distributions in an amount at least equal to their adjusted net income less certain taxes and adjustments. However, the Code also authorized foundations to apply any excess qualifying distributions from the 5 preceding years to their qualifying distribution requirement. In addition, the Code authorized foundations to make the required qualifying distributions during the year following the year of the earnings. The data base we analyzed did not contain sufficient information to allow us to determine how these multi-year considerations affected private foundation expenditure patterns. Accordingly, our analysis was limited to the foundations' tax year disbursements for charitable purposes and qualifying distributions.

--Attachments XVII and XVIII were compiled to show the extent to which foundations apply their earnings--adjusted net income as previously described--to the conduct of charitable activities as measured by charitable purpose disbursements--attachment XVII--and qualifying distributions--attachment XVIII. These two measures of charitable activities are described in detail in previous sections. Both attachments rank the foundations by the amount of their charitable activity as a percentage of their adjusted net income.

To assist the Subcommittee in reviewing the investment practices of private foundations and evaluating how foundations have operated under section 4943 of the Internal Revenue Code, we also analyzed microfiche records of the most recent foundation returns available as of December 1982--primarily tax year 1981 returns--for private foundations reporting assets of $1 million or more.

Generally, under section 4943, a foundation and all disqualified persons, such as the foundations' officers, directors, substantial contributors, and certain of their relatives, may not own together more than a 20 percent interest in a business. This section also provides a series of transitional rules for foundations which held stock on May 26, 1969. These transitional rules prescribe time periods for foundations to divest their excess holdings based on the extent of their holdings in 1969. One such divestiture period ends on May 26, 1984.

In general, the excess business holdings provisions of section 4943 only apply if a foundation owns at least 2 percent of the voting stock and at least 2 percent of the value of all outstanding shares of all classes of stock, regardless of the ownership by disqualified persons.

Of the 3,851 returns reviewed, 365, or 9 percent, reported owning 2 percent or more interest in a for-profit business. We used the 2 percent figure because of the de minimis rule on excess business holdings, as specified by section 4943 of the Code. Although IRS does not require foundations to report any further information on the nature or extent of these holdings, foundations are required to report the identity, market, and book values of all stock held. Attachment IV is a listing of these 365 foundations, their two largest stock holdings, and the extent to which these holdings account for the total fair market value of the foundation's assets. Attachment V is a summary chart of the line item information shown at attachment IV.

In addition to the previously described work, we also reviewed available IRS historical data on foundation financial resources. However, it should be noted that it is difficult to interpret this information or to determine long-term trends in private foundation growth for two reasons. First, data relating to private foundations has not been consistently or continuously kept over the years. Second, changes in the tax exemption laws make comparisons imprecise.

Within these limitations, however, IRS' Statistics of Income Division published three studies on private foundations which covered selected years between 1962 and 1979. Attachment I contains selected data from these studies, as well as other data which we developed for 1980 and 1981 based on information available from IRS' master file. To place the year to year data on the same basis so comparisons could be made in real terms and not in terms of inflated dollars, we applied the Gross National Product Implicit Price Deflator to the current dollar data. We selected this deflator instead of others because it is a broader measure of financial activity and, thus, is not as prone to substantial year to year variations as some other deflators.

Mr. PICKLE. First I want to ask a general question. One of the Members of Congress who testified before us this morning made the statement that there was a decline in the foundation's grant making capacity.

"In the 1970's, only one-third as many new foundations were established as during the 1960's." That was a quote. "Lifetime giving to foundations has dropped precipitously to only a fraction of the pre-1969 level, and between 1969 and 1981, the value of foundations' assets, thus their future grant capability, measured as a percentage of GNP, has dropped by 40 percent."

Now, the figures you gave initially, as you started, indicated that foundations were growing both in number and in volume, and that their contributions were greater. Did I misunderstand your general statement?

How does that compare with what was made by one of the Members of Congress just prior to your testimony?

Mr. FINCH. You interpreted my statement correctly, sir. Our figures indicate that foundations are growing; that their financial well-being seems to reflect an increase in virtually every variable that we tried to measure, that being the number of foundations have increased from 1962 to 1981; the fair market value of their assets have increased, the value of their total receipts have increased, their total expenses have increased, and their charitable disbursements have increased.

Mr. PICKLE. We would feel that GAO should be an authority in this field and we want to accept your figures, but in view of the fact there is a difference of opinion, we will check that further, because we need to establish the facts.

Mr. FINCH. Sure.

Mr. CONABLE. Will you yield, Mr. Chairman?

Has there been a change in the rate of growth, rate of formation?

It continues to grow, you say, but has it declined somewhat over the formation percentage?

Mr. FINCH. Between the years, no, I don't see that from scanning the figures in front of me here.

In 1962, the number of foundations was 14,865; in 1974, 26,889; in 1977, we are at 27,691; and in 1978, 29,659.

Mr. CONABLE. Are you aware also, that a number of private charities have been redefined as foundations because of loss of their contribution base?

Mr. FINCH. Yes, sir.

Mr. CONABLE. And therefore they are not private foundations in the same sense as a foundation that came into being is a private a foundation?

Mr. FINCH. Yes, sir. Perhaps the difference between the figures that I presented and the figures of the previous witness lie in the source of the figures.

Our figures are drawn from IRS's master file.

Mr. CONABLE. Thank you.

Mr. PICKLE. And the IRS yesterday in effect corroborated your statement.

Mr. FINCH. Yes.

Mr. PICKLE. The other figures must come from the council.

Mr. FINCH. It is my understanding that the council, yes, the council does use a bit of a different definition in terms of defining what is a foundation and what is not.

Mr. CONABLE. You acknowledge, do you not, that it is not really a private foundation if all it is is a failed charity that has lost its contribution base and, therefore, comes under the technical definition of private foundation even though it may have become almost dormant as a result of the decline in contributions to a 501(C)(3)? My understanding is there are a great number of organizations in that category and to call them private foundations would be misleading at best.

Does your study show there are a number of organizations like that involved?

Mr. RICHARDS. Mr. Conable, we really can't respond based on the data that we had available to determine the exact number of charities that had been reclassified as private foundations.

One point of view may well be that most organizations classified as private foundations in 1969 may have preferred to have been classified as public charities at that time. So to a degree, one perspective may have it that all organizations have at one point in time been subject——

Mr. CONABLE. I can't hear you, sorry.

Mr. RICHARDS. All of them may have been subject to the technical definition of what constitutes a private foundation. Also, the public charity that loses support and is redefined as a foundation; may well be carrying out sizable programs of an operational nature or directly delivering services or in the capacity of making grants.

Mr. DUNCAN. Would you yield, Mr. Chairman?

Mr. PICKLE. I yield.

Mr. DUNCAN. I understand from the testimony yesterday that perhaps there is less giving today relative to the gross national product than there has been in a long number of years. Do you have any information as to the statement that there is less giving based on the gross national product than there has been in the past?

Mr. FINCH. No, sir, we didn't—the analysis we did was not based on GNP data per se.

What we did was analyze giving as a percentage of total receipts of foundations and as total assets of the foundations.

Mr. DUNCAN. On page 10 of your testimony, you say you obtained estimates in terms of constant dollars. You applied the gross national product implicit price inflator to current dollar data.

Mr. FINCH. That was to level out dollars to make them constant at one base.

Mr. DUNCAN. Well, is that true? You should be able to answer the question I asked, then. If you actually based your estimates on the GNP in constant dollars, can you answer it?

Mr. FINCH. We didn't compute percentages based on each year's GNP figure.

Mr. DUNCAN. Can you do that?

Mr. FINCH. Yes, sir.

Mr. DUNCAN. Would you do that for the record?

Mr. FINCH. We would be happy to.

Mr. DUNCAN. Thank you, sir.

[The information follows:]

CONTRIBUTIONS PAID BY AND MADE TO PRIVATE FOUNDATIONS AS A PERCENTAGE OF GROSS NATIONAL PRODUCT (GNP) [1]

[Dollars in millions]

Selected years [2]	Gross national product	Contributions paid by private foundations		Contributions made to private foundations	
		Amount	Percent of GNP	Amount	Percent of GNP
1962	$546,900	$932	.17	$833	.15
1974	1,379,400	1,953	.14	1,217	.09
1977	1,862,800	2,289	.12	1,823	.10
1978	2,091,300	2,764	.13	1,837	.09
1979	2,357,700	2,801	.12	2,282	.10
1980	2,573,900	3,100	.12	2,014	.08
1981	2,871,800	3,700	.13	2,560	.09

[1] Source is GAO analysis of data from S01 Bulletin (Pub. 1136) dated October 1982, Private Foundations 1974–78 (Pub. 1073) dated April 1981, Statistics of Income Division, Internal Revenue Service; Treasury Department Report on Private Foundations, 1965, Department of the Treasury; Budget of the United States, 1981 and 1984; and the IRS Master File data as reported to IRS Exempt Organizations Division.

[2] Selected years were dictated by data availability.

Mr. PICKLE. In terms of tax exempt purposes, what factors should the Congress and the administration be monitoring to assure that foundations are spending maximum dollars to support charitable activities?

What factors should we really consider to make an evaluation?

Mr. FINCH. I think, sir, there are several factors. Before I mention those, let me first make a leading point, if I might.

That point deals with the kind and amount of data that is being reported and is being maintained for oversight purposes. Data is available but it is really hard to come up with long-term trend information concerning private foundations.

The reason for that is that a lot of data has not been kept continuously or consistently over the years. Another thing that makes the data analysis really difficult is that changes in the laws make comparisons imprecise over a period of time.

Recently, in the work we did in terms of looking at the completeness of private foundation returns, we noted that there are several instances of return items where full disclosure is not really being made. Actions are now being taken by IRS and by the foundations to correct that problem.

One of the things that IRS has done in consort with the foundations is to set up an advisory committee to discuss the reporting form, the 990-PF.

I would suggest that one thing this committee might wish to discuss with IRS or consider in its deliberations is that the focus of that advisory committee might not be solely on the clarity of the requirements of the form, but also on the data that needs to be maintained and kept for effective oversight.

Some of the things in response to your question, in direct response to your question, sir, that I think perhaps you should consider in the future——

Mr. PICKLE. Mr. Finch, let me conclude this part of our discussion. We will try to establish what are the facts about them.

Mr. FINCH. Yes, sir.

Mr. PICKLE. We will try to make an analysis and we may ask you to help us in following through.

Mr. FINCH. Be happy to.

Mr. PICKLE. Now, what factors should the Congress and the administration consider to assure we are spending the maximum dollars for the best purposes? What factors do you think we should consider?

Mr. FINCH. I think some of the factors you should look at would be the minimum payout provision recently changed in 1981. There is data now available which could be used to do a pre- and post-analysis after a sufficient period of time has passed.

Another aspect that I would think that you would be interested in would be the amounts and nature of charitable disbursements that the foundations are making. By the same token, the makeup of their qualifying distributions and also an analysis of the expenses they are incurring.

Mr. PICKLE. What was the last point?

Mr. FINCH. The expenses they are incurring.

Mr. PICKLE. How many foundations pay out for charitable purposes more than the minimum required? Do you know that?

How many just comply with the law by paying out the minimum? Do you know that?

Mr. FINCH. I am trying to think, sir. We have so many figures floating around, I was trying to think of one that could be used to get at that question.

I think adjusted net income is one measure which the Congress described as the amount available to foundations for making disbursements for charitable purposes.

As I recall, we found that in the neighborhood of 70 percent of foundations which earned some adjusted net income, they were paying out 90 percent or better of their adjusted net income.

Mr. PICKLE. All right. Thank you very much.

Now, Mr. Conable or Mr. Duncan?

Mr. CONABLE. No questions.

Mr. DUNCAN. No further questions.

Mr. PICKLE. Mr. Anthony.

Mr. ANTHONY. Thank you, Mr. Chairman.

After reviewing the expenses and looking at your testimony on pages 30, 31, I've become concerned that, numerically speaking, we have quite a few foundations in which expenses exceed charitable contributions. You indicated that in some cases there were not any charitable contributions.

Are there improvements we could make to the 990-PF, for example, for better identification of the data base?

As I go through your testimony, one of the things that you make very clear to us is that neither Treasury nor GAO has a data base in which you can make an intelligent critical analysis of what is going on. Therefore, when we are asked to make some changes, we are not going to have the data base necessary, if I interpret your testimony correctly.

Are there some improvements that we can make that could identify the guarantees, the potential excess business holdings, the amount of administrative expenses actually spent on charitable purposes, and also the amount of qualifying distributions counted for purposes of meeting the minimum payout that flows out to charities?

I think that was found on page 31 of your testimony.

Could you give us some recommendations today or even follow up with a letter to the committee as to how we can improve the data collection process so that we could know exactly where we are?

Mr. FINCH. I think that is an excellent point. You have interpreted our message and Treasury's message exactly right in terms of the data base available for analysis.

I don't have any suggestions off the top of my head. We will be more than happy to work with the subcommittee staff and try to come up with some suggestions in that regard.

I would also encourage the subcommittee to pick up on the point I made in response to a previous question about encouraging IRS and its advisory committee—which is presently in the process of going over the clarity of the form—to also think about what kinds of information would be needed for effective oversight purposes, because I think that, too, would be a good source to the subcommittee in terms of coming up with answers to the question you just posed.

Mr. ANTHONY. We have heard from a panel of congressional witnesses, and later will hear from a panel of people representing specific foundations. They have made special arguments which sound very good and plausible.

But when you talk about the huge growth in foundations—some large, some small, some making a good return, some not making a good return, some making only 1 percent—there ought to be some questions asked about why they are not doing better than 1 percent and why the large foundations are doing better than the small ones?

I would hate to make some vital decisions with an inadequate data base. I am not looking for the Government to kill them with forms either. I am from the business community, you know. But, at the same time, I am trying to get the data.

We need your help in simplifying this so we will not have an excess of paperwork that will not be utilized.

Mr. FINCH. We will be more than happy to work with the subcommittee.

Mr. ANTHONY. You are recommending we contact the advisory committee over at Treasury?

Mr. FINCH. Yes.

Mr. ANTHONY. They are doing the same thing.

Mr. FINCH. That will then give you two inputs: from the administrator of the law and the users, the people that have to comply with the law, as well.

I think those two would be good additional sources for you.

Mr. ANTHONY. I yield back, Mr. Chairman.

Chairman RANGEL. Who has the time?

Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman. I have no questions.

Chairman **Rangel**. Mr. Stark.

Mr. **Stark**. No questions, Mr. Chairman.

Chairman **Rangel**. Let me thank the gentleman for the great work we have come to expect you to do, and tell you that we will be in touch with you. We may have questions from Members who were not here and we will appreciate your response.

[The following was subsequently received:]

COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, D.C., July 15, 1983.

Mr. JOHN FINCH,
Associate Director, U.S. General Accounting Office,
Washington, D.C.

DEAR MR. FINCH: Thank you for your participation in the Oversight Subcommittee's recent hearings concerning private foundations. In order to complete our hearing record, your response to the following questions would be appreciated:

(1) You have stated that your conclusions about what foundations are doing are "qualified" due to limited data. The Treasury Department testified, similarly, that it did not have data necessary to evaluate the impact of the 1969 Act.

What kind of data is needed that is not available now?

How can that data be obtained?

(2) What ways are there to evaluate private foundations and which are the most useful to the Congress and the general public?

(3) What types of improvements can be made to the Form 990-PF to identify:

Grantees;

Potential excess business holdings;

The amount of administrative expenses actually spent on charitable purposes; and

The amount of "qualifying distributions" counted for purposes of meeting the minimum payout that actually flows out to charity?

(4) How many foundations pay out for charitable purposes more than the minimum required?

(5) The Council on Foundations and others state that the 1969 Act has caused a dramatic decline in the creation and continuation of private foundations. Does your statistical analysis support this view?

(6) In 1969, Mr. Patman submitted to the Committee on Ways and Means a list of private foundations with substantial holdings of nationally-known companies. Does your data reflect how many of these foundations continue to hold this stock?

(7) Should we conclude from your analysis of rates of return on various foundation investments (page 9 of your statement) that if diversification of investments were required, foundations generally would have more funds to pay out for charitable purposes?

I would appreciate your response by Friday, August 5, 1983. If you have any questions, please contact Bill Kirk, Staff Director, or Rusty Guritz, Assistant Counsel, of the Subcommittee staff at 225-5522.

Thank you for your assistance.

Sincerely yours,

CHARLES B. RANGEL,
Chairman.

U.S. GENERAL ACCOUNTING OFFICE,
Washington, D.C., August 19, 1983.

Hon. CHARLES B. RANGEL,
Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives.

DEAR MR. CHAIRMAN: In a letter dated July 15, 1983, you requested that we respond to seven questions to complete the record of recent hearings concerning private foundations.

Your questions and our responses are enclosed. Our response to question six will be supplemented with some additional information which we have requested from the Internal Revenue Service. We will forward this information to your staff as soon as we receive it.

If you or members of the Subcommittee have any additional questions or need further assistance, please contact us.

Sincerely yours,

JOHNNY C. FINCH,
Associate Director.

Enclosure.

Question (1). You have stated that your conclusions about what foundations are doing are "qualified" due to limited data. The Treasury Department testified, similarly, that it did not have data necessary to evaluate the impact of the 1969 act.

What kind of data is needed that is not available now?

How can that data be obtained?

GAO response: To evaluate the impact of the 1969 Tax Reform Act and/or develop a profile of private foundations' operatons and activities, one would need substantial detailed data. However, data covering the pre-1969 operations of private foundations is extremely limited. Post-1969 data, while more extensive, still lacks sufficient detail for evaluating some of the more pertinent aspects of private foundation operations. The problem is further compounded in that the same data elements have not been recorded from year to year so as to facilitate trend analysis. Thus, a mechanism is needed for identifying the specific kinds of data that foundations should report and that the Government should record to provide an appropriate basis for oversight of foundation operations and for evaluating the effects that legislation has had on those operations.

If the necessary data were available, an effective evaluation of legislative impact would involve several steps. First, data on the pre-act environment would have to be collected and analyzed to identify problems and the extent of those problems. Second, data on the post-act environment would have to be collected and analyzed to see if trends can be developed to determine whether the problems still exist and, if so, to what extent. Through comparisons between pre-act and post-act data, insights could be obtained as to whether the legislation is having its intended effect. In the instance of the Tax Reform Act of 1969 and its effect on private foundations, however, the available data does not readily lend itself to this kind of analysis. Neither IRS nor the Department of the Treasury developed much information on the operations and activities of private foundations before 1969. In fact, data is available only for 1962 and the scope of that data is severely limited. The data is limited in that it did not cover all foundations operating at the time because of uncertainties over the definition of a "private foundation" and in that it dealt only with total measures of certain revenues, expenses, and assets. Neither did IRS retain data on foundation operations and activities for the years immediately following passage of the act—1969 through 1973. Therefore, pre-act and post-act comparisons can not be readily made to evaluate the impact of the 1969 legislation.

Similar data limitation problems complicate the task of developing a profile of foundation operations and activities. To complete that task, one would need comprehensive data, consistent in content, collected over a sufficient period of time to facilitate trend analysis. While more data is available for recent years, that data is neither sufficiently consistent in composition nor available for a sufficient period to permit conclusions to be drawn on the effectiveness and efficiency of foundation operations and activities. For example, IRS' Statistics of Income Division has published studies dealing with private foundation operations and activities in 1974 and 1979. The 1979 study encompassed over 150 data items recorded from each of a sample of 9,438 private foundation returns. Since 1981, however, IRS has routinely recorded and maintained computerized data on only 25 items. The retention period for this data is 4 years.

Thus, information shortcomings prohibit thorough evaluations of private foundation activities and the effects that legislation has had on those activities. These shortcomings need to be reserved so that future evaluations can be made to more definitively answer questions that arise through the oversight process. However, determining precisely what information should be accumulated and recorded is not an easy task. In making those determinations, it is essential that consideration be given to the information needs of IRS, the Congress, and the public—particularly grant seekers and those interested in foundation accountability—as well as the cost of meeting those needs. The needs of each should be balanced against the cost IRS would incur in collecting, processing, and compiling additional information and the cost foundations would incur in reporting that information. Therefore, as a starting point, information "users," "providers," and "processors" should be brought together to discuss information needs, to identify trade-offs between the benefits of complete information and the costs of making that information available, and make the results of their efforts known to the Congress. One group which could be so tasked is IRS' newly established advisory committee on tax-exempt organization public reporting.

Question (2). What ways are there to evaluate private foundations and which are the most useful to the Congress and the general public?

GAO responses: There are several ways to conduct evaluations of private foundations. To identify the best way, one must first consider the issue of interest to the Congress or the general public. For example, some issues of interest, such as whether foundations are increasing in numbers, becoming more financially sound, or making more charitable grants, can perhaps best be addressed through monitoring national statistics compiled from foundation return information filed with IRS—provided, of course, that the data maintained by IRS is sufficient. Other issues of interest to grant seekers, such as the types and amounts of grants particular foundations make, may best be addressed through a review of the returns filed by those foundations. Still other issues, such as the effectiveness of foundation investment practices or identification of potential excess business holdings would probably be best addressed through a detailed study of a representative sample of individual foundations. This is because foundations are not required to report extensive information on their investment programs or holdings.

In general, the choice of evaluation method depends on the issue that it to be evaluated and the data available for addressing that issue. In selecting an appropriate evaluation method, the following sources of information should be considered:

Foundation return information computerized by IRS;

Foundation returns filed with IRS and on file in many libraries;

Foundation responses to specific questions or questionnaires; and

Foundation operational documents supplemented by discussions with foundation managers.

Question (3). What types of improvements can be made to the form 990-PF to identify:

Grantees;

Potential excess business holdings;

The amount of administrative expenses actually spent on charitable purposes; and

The amount of "qualifying distributions" counted for purposes of meeting the minimum payout the actually flows out to charity?

GAO response: As previously discussed under Question (1), any changes to the reporting requirements should be preceded by consideration of the information "users" need and the costs to the information "providers" and "processors". Accordingly, the following potential modifications to foundation reporting are suggested for such need versus cost considerations.

GRANTEE INFORMATION

Currently, foundations are not required to report to IRS information describing grant recipients, such as information on the nature and size of their activities or on whether they are new "grass-roots" organizations or well-established "traditional" organizations. According to some people interested in foundation activities, such information would be useful in ascertaining the extent to which foundation support is directed to meeting new social problems as opposed to sustaining traditional organizations such as colleges, universities, and hospitals. The return could be modified to report this information by using codes to categorize grant recipients and/or by providing space to record the recipients' employer identification number. The former approach would actually describe the organizations on the return, the latter would permit the development of the information from IRS files.

INFORMATION ON POTENTIAL EXCESS BUSINESS HOLDINGS

The Internal Revenue Code limits the extent to which foundations can own for-profit businesses. Generally, under section 4943, a foundation and all disqualified persons, such as the foundation officers, directors, substantial contributors, and certain of their relatives, may not own together more than a 20 percent interest in a business. This section also provides a series of transitional rules which prescribe time periods for foundations to divest themselves of their excess business holdings. One such divestiture period ends on May 26, 1984.

Currently, foundations are neither required to report the identity of stock holdings subject to the divestiture provisions nor the identity of the holdings of all disqualified persons. Similarly, foundations are not required to report information on stock holdings they have divested to comply with the excess business holdings provisions. Without this basic information, it is most difficult to assess the effect the excess business holding provisions have had, or are having, on foundation operations and activities. The return, however, could be modified to record this information.

ADMINISTRATIVE EXPENSE INFORMATION

Currently, private foundations are required to report to IRS all expenses incurred during the tax year according to the following categories:

Compensation of officers and directors;
Other salaries and wages;
Pension plan contributions and other employee benefits;
Investment, legal and other professional services;
Interest;
Taxes;
Depreciation, amortization, and depletion;
Contributions, gifts, and grants made; and
Other expenses (a supplementary explanatory list is required).

Within each category, foundations are required to break out the amount of disbursements for exempt purposes and the amount of expenses incurred in raising revenues. To do this, foundations are instructed to report disbursements for exempt purposes on a cash basis, and to report expenses incurred in raising revenues according to the accounting method (cash or accrual) used in recording those expenses in the foundations' books and records.

Because foundations are not required to identify administrative expenses incurred, there is no assurance that the amount of administrative expenses for charitable purposes can be determined by reviewing the return. For example, in the instance of a foundation which makes grants as well as directly carries out charitable activities (such as providing services to the community), one cannot determine from reviewing the return how much was spent in the direct delivery of charitable services versus the amount spent to administer these services or to administer grant programs.

Another problem is that amounts reported by private foundations as disbursements for exempt purposes may, under certain circumstances, understate both the charitable expenses actually incurred and the amount of associated administrative expenses. Specifically, foundations which engage in charitable activities that also produce revenue are instructed to report associated expenses as disbursements for exempt purposes only to the extent that the expenses exceed the revenue earned. Therefore, the amount reported as a disbursement for exempt purposes would not account for the full cost of the charitable activity. Neither would the total amount of administrative expense be readily determinable.

To the extent a better measure of administrative expenses is needed to facilitate oversight of private foundation operations, appropriate modifications could be made to foundation returns so that the needed information could be obtained.

QUALIFYING DISTRIBUTION INFORMATION

As a condition for tax exempt status, the Internal Revenue Code requires foundations to incur certain kinds of costs which, in total, are to equal or exceed a computed minimum. These costs are called qualifying distributions. Currently, foundations are required to report the following major components of their qualifying distributions:

Total disbursements for exempt purposes,
Amounts paid for program related investments,
Amounts paid to acquire assets used (or held for use) in directly carrying out charitable purposes, and
Amounts set aside for specific charitable purpose projects.

Of these components, the most significant in terms of dollar volume is disbursements for exempt purposes. In 1979, this component accounted for about 94 percent of total qualifying distributions.

Notwithstanding the significance of exempt purpose disbursements in determining whether foundations have made the requisite total of qualifying distributions, the actual amount of exempt purpose disbursements that flow out to charity cannot be readily determined from the information presently reported on the return. This is because the direct disbursements and the administrative expenses of making those disbursements are reported as a composite total. As mentioned in the discussion above, modifications to the return could be made to capture this information if a better measure of charitable disbursements is desired.

Question (4). How many foundations pay out for charitable purposes more than the minimum required?

GAO response: For tax year 1979, the Internal Revenue Code required most foundations to make qualifying distributions in an amount equaling the greater of adjusted net income of the foundation or the minimum return the foundation was expected to earn on its invested assets (essentially 5 percent of the value of those assets) less certain taxes and adjustments. Our analysis of tax year 1979 data showed that of the 223,280 foundations which reported required distribution of at least one dollar, about 2 percent made qualifying distributions equaling the required amount and about 60 percent exceeded the required distribution amount. A breakdown of the 23,280 foundations by percentage of qualifying distribution to required amount is shown below.

Within each category, foundations are required to break out the amount of dis-

Percentage range of 1979 qualifying distribution to required amount	Percentage of foundations according to required distribution amount				
	$1 to $24,999	$25,000 to $99,999	$100,000 to $999,999	$1 million and over	Total
1 to 19	9	3	3	1	8
20 to 39	2	3	3	1	2
40 to 59	4	5	5	6	4
60 to 79	8	12	12	15	9
80 to 99	12	24	32	41	16
100	2	3	3	1	2
101 to 119	12	19	17	16	14
120 to 149	8	11	8	8	9
150 to 199	6	6	6	4	6
200 to 299	6	5	4	3	6
300 and over	30	10	7	3	25
Total	100	100	100	100	100
Number of foundations	17,190	3,582	2,158	350	23,280

Note: Details may not total due to rounding.

The Internal Revenue Code authorizes foundations to apply any excess qualifying distributions from the 5 preceding years to offset their distribution requirement. In addition, the Code authorizes foundations to make the required qualifying distributions during the year following the year of earning. However, the data base we analyzed did not contain sufficient information to allow us to determine how these multiyear considerations affected private foundation expenditure patterns. Thus, the distribution statistics for 1979, standing alone, may not be indicative of multiyear spending patterns of the foundations.

Question (5). The Council on Foundations and other state that the 1969 Act has caused a dramatic decline in the creation and continuation of private foundations. Does your statistical analysis support this view?

GAO response: Our analysis of available IRS historical data shows that private foundations have continued to increase in numbers and financial strength since 1969. The rate of their growth in numbers, however, has been substantially less than the rate for the 10 year period preceding the act. On the other hand, their financial growth, as measured by the percentage of increase in the dollar value of contributions received by foundations, has exceeded the percentage of growth in the U.S. economy as measured by the Gross National Product.

In 1980, IRS' Statistics of Income division completed a statistical analysis of the returns filed by private foundations in 1974. Those returns required each foundation to report the date the foundation obtained its tax exemption letter from IRS. As shown in the following chart, which we compiled from the IRS data, 6,061 foundations obtained tax exemption during the 1950s, 12,094 during the 1960s, and 5,085 during the first five years of the 1970s.

[Dollars in thousands]

Date of exemption	Grant making foundations		Nongrant making foundations	Total foundations
	Number	Grant amount		
No year reported	730	$19,194	443	1,173
Before 1920	([1])	([1])	([1])	([1])
1920–39	331	365,129	70	401
1940–49	1,774	343,355	297	2,071
1950–59	5,506	649,744	555	6,061
1960–69	10,077	433,734	2,017	12,094
1970	909	41,662	338	1,247
1971	802	20,011	290	1,092
1972	763	39,814	318	1,081
1973	539	22,666	270	809
1974	522	17,444	334	856
Total	21,956	1,953,060	4,933	26,889

[1] Estimate is not shown separately because of the limited number of sample returns on which it was based. However, the data are contained in the appropriate totals.

Note: Detail may not total due to rounding.

In 1982, the Statistics of Income Division completed a study in which it updated the 1974 data with 1979 data. In 1979, however, foundations were not required to report the date that they obtained exemption. Thus, we could not update the analysis in this respect. We were, however, able to make some comparisons of the return data for the 2 years. These comparisons, as shown below, indicated a more limited growth in the numbers of foundations between 1974 and 1979 than for the 1970 to 1974 period. On the other hand, when measured against the percentage increase in the Gross National Product, the growth in contribution dollars received by foundations has exceeded the financial growth of the economy as a whole.

Description	1974	1979	Percent increase
Number of foundations:			
Grant-making	21,956	22,564	2.8
Non-grant-making	4,933	5,416	9.8
Total	26,889	27,980	4.1
Contributions (millions): Received by foundations	$1,217	$2,282	87.5
U.S. gross national product (billions)	$1,379	$2,358	71.0

Question (6). In 1969, Mr. Patman submitted to the Committee on Ways and Means a list of private foundations with substantial holdings of nationally-known companies. Does your data reflect how many of these foundations continue to hold this stock?

GAO response. In testimony given February 18, 1969, before the Committee on Ways and Means, Congressman Wright Patman listed 29 private foundations having substantial stock holdings of nationally-known companies. We updated the status of the holdings of 23 of those 29 private foundations based on the most recent returns the foundations had filed with IRS as of December 1982. We will provide information on the status of the other 6 foundations as soon as IRS locates the returns.

Nine of the 23 private foundations no longer own stock in the nationally-known companies:

Private foundation	Company	Company stock owned as reported in 1969	
		Type	Percent
Wm. T. Morris Foundation	American Chair & Cable Co., Inc	Capital voting	17
Ford Foundation	Ford Motor Co	Class A nonvoting	100

Private foundation	Company	Company stock owned as reported in 1969	
		Type	Percent
John A. Hartford Foundation	Great Atlantic & Pacific Tea Co	Common voting	34
Norton Simon Foundation	Hunt Foods and Industries, Inc	do	8
James Irvine Foundation	Irbine Co	do	53
Kresge Foundation	S. S. Kresge Co	Capital voting	22
DeRance Inc	Miller Brewing Co	Common voting	47
Woods Charitable Fund, Inc	Sahara Coal Co., Inc	Preferred nonvoting.	36
		Common voting	24
H. J. Kaiser Foundation	Kaiser Industries Corp. (liquidation of company commenced Apr. 20, 1977).	do	15

Fourteen of the 23 private foundations still own stock in the nationally-known companies:

Private foundation	Company	Company stock owned as reported in 1969		Current percent of stock owned [1]
		Type	Percent	
Altman Foundation	B. Altman & Co	Capital voting	95	98.0
Moody Foundation	American National Ins. Co	Common voting	35	25.7
Cannon Foundation	Cannon Mills Co	do	16	8.5
Duke Endowment	Duke Power Co	do	57	18.0
Olin Foundation, Inc	Federal Cartridge Corp	do	100	100.0
		Preferred nonvoting.	100	100.0
Howard Heinz Foundation	H. J. Heinz Co	Common voting	17	7.7
W. K. Kellog Foundation Trust	Kellog Co	do	51	47.5
Lilly Endowment Inc	Eli Lilly & Co	Common	24	18.0
McDonnell Foundation	McDonnell Aircraft Corp. (name changed to McDonnell Douglas Corp. on Apr. 28, 1967).	Common voting	7	2.1
Danforth Foundation	Ralston Purina Co	do	20	5.2
Phoebe Waterman Foundation (now the William Penn Foundation).	Rohm & Haas	do	19	18.2
Pew Memorial Trust	Sun Oil Co	do	22	15.0
Timken Foundation	Timken Roller Bearing Co. (name changed to Timken Co. Apr. 20, 1970).	do	10	3.9
Charles Stewart Mott Foundation	United States Sugar Co	Common	48	24.8

[1] Source is mircofiche copies of tax returns, from 990-PF, furnished in December 1982 by IRS for the most recent available year for private foundations with assets of more than $1 million; and supplemented with information from CDE Stock Ownership Directory, Series No. 5 (July 1981) published by the Corporate Data Exchange, Inc.; Standard Corporation Descriptions, published by Standard and Poor's Corporation, 1983; an official at Federal Cartridge Corp., Anoka, Minnesota; New York Times, August 11, 1982; or Moody's Industrial Manual, 1979 to 1982.

Question (7). Should we conclude from your analysis of rates of return on various foundation investments (page 9 of your statement) that if diversification of investments were required, more monies would be available for charitiable purposes?

GAO Response: Our objective in analyzing foundation investments was to determine if differences in the general categories of private foundation assets—such as investments in corporate stocks and bonds, cash investments, government securities, or other investments—affected the rate of return earned during 1979. While the data available was sufficient for us to achieve our objective, it was not sufficient for measuring the effect of portfolio diversification. To make that measure, one would need additional data including (1) the rates of return on investments over several years, (2) the degree foundations' investment strategy complemented their charitable goals, (3) the degree of risk assumed by foundations to earn the rate of return, (4) the long term capital gains earned, and (5) the earings of each security. Typically, this information, together with other information such as the type of industries invested in and the performance of alternative investments, would be needed to analyze the effect of portfolio diversification.

In summary, existing data does not permit us to reach informed conclusions regarding the impact that a diversified investment portfolio might have on a private foundation's ability to pay out more for charitable activities. However, it is generally recognized as an investment principle that an effectively constructed investment portfolio should be diversified to minimize the portfolio's risk. One effect of diversification would be to provide a more constant level of income. Thus, while diversification of a foundation's portfolio may not always provide a higher rate of return and thereby make more monies available for charitable purposes, it should provide a more consistent level of income to meet charitable objectives.

Chairman RANGEL. Next we have a panel, the Institute for Research on the Economics of Taxation, Norman Ture, chairman of the board; Malcolm Stein, partner, Roberts & Holland; Joseph DioGuardi, tax partner, Arthur Andersen & Co.; and J. Stoddard Hayes, member, Trust Taxation Committee, American Bankers Association.

Staff informs me that the subcommittee members have your prepared statements, and if there is no objection from the subcommittee, the statements will be entered into the record as they are. So you can proceed.

We will be operating on the 5-minute rule. I assume Mr. Pickle has informed the panels of that.

I ask the members also to consider that so that we will be able to hear all of the witnesses today.

Mr. Ture.

STATEMENT OF NORMAN B. TURE, CHAIRMAN OF THE BOARD, INSTITUTE FOR RESEARCH ON THE ECONOMICS OF TAXATION

Mr. TURE. Thank you, Mr. Chairman, members of the committee. It is a pleasure to appear today.

I am chairman of the Institute for Research on the Economics of Taxation, IRET, which is a public policy research organization focusing on public economic policies.

The subject of the tax rules applicable to private foundations with which the subcommittee is concerned in these hearings is both broad in scope and complex.

I would like to confine my discussion to two provisions, 4942 and 4943. I submit these should be repealed in the interests of allowing private foundations to function more effectively.

In 1973, I prepared a detailed analysis and evaluation of section 4942, the minimum distribution rule, and that was presented to the Committee on Ways and Means by the ad hoc committee on section 4942. I would be delighted to provide a copy of that for the record of this hearing if the subcommittee desires.

In addition, one of IRET's current undertakings is a set of studies of the provisions in present law pertaining to private foundations. We will be pleased to share with the subcommittee the results of these studies as they become available.

Dealing first with section 4942, the minimum distribution rule, this section imposes a tax of 15 percent initially and subsequent taxes under certain circumstances of 100 percent on undistributed income, which is defined as the excess of foundations' net income over minimum investment return.

The latter is defined for tax years after 1981 as 5 percent of the fair market value of the foundation's net assets. This section was enacted in the Tax Reform Act of 1969, ostensibly for the purpose of eliminating the uncertainty of prior law under which the foundations accumulating income in unreasonable amounts, or over an unreasonably long period, might lose their tax exempt status.

Failure by a foundation to distribute its income was deemed to be an abuse, in that the donor of the foundation's assets received a tax benefit from the charitable contribution deduction, but there were no current benefits in the form of grants being received by charities to justify the donor's tax savings.

The principal objective of 4942, accordingly, was to avert any such abuse by requiring private foundations to distribute promptly to charities virtually all the foundation's earnings.

There is little a priori basis for holding that the optimum distribution policy with its consequent implications for selection of the foundation's assets is one in which all or a substantial part of the returns on the foundation's assets are currently distributed. It should be clear that today's distribution reduces tomorrow's capacity to distribute.

Efficient distribution policy, if the foundation were free to devise it, would be guided by considerations of the specific charitable activities which the foundation wants to support, present demands of such charities relative to those which may be reasonably anticipated at a future date, the capacity of donees effectively to use additional grants compared with their use later, and so forth. The balance among these numerous considerations dictate efficient distribution policy.

The minimum distribution rule does not preclude an efficient distribution policy for every foundation, but it passes belief that it does not significantly distort that policy for many foundations, hence reduce their capacity to serve over time the purposes for which they were created.

If there is a public policy consensus that the demands imposed by charities for private financial support are growing, and are likely to continue to do so at an accelerating rate, it should be recognized that section 4942 is likely to be at odds with that objective.

For many foundations, compliance with 4942 exerts pressure to reconstitute portfolios in favor of assets with relatively high current yields as opposed to those with strong growth potential.

The foundation with a substantial proportion of assets in the stock of a low payout/high growth corporation may very well be required under the minimum distribution rule to liquidate significant amounts of its assets while another foundation with a substantial part of its assets in high-payout-low-yield shares in a slower growing company may be under no such constraint.

In terms of investment performance and capacity to provide financial support to charities, the first foundation may well be highly superior to the second. The impact of the minimum distribution rule in such cases is counterproductive.

Moreover, if the first foundation stock is in a closely held company for which little or no market exists, the foundation may be put into an impossible position with respect to both effective management of its investments and building the capacity to support charity over the long pull.

The minimum distribution rule obviously disregards and overrules a variety of charitable giving objectives: The differences in present grant making capacity, the differences in present and future demands for grants and different endowments of the foundations.

It substitutes a tax consideration for the relevant market determinants of optimum foundation distribution policies. It imposes these costs allegedly to prevent abuse by what must have been in the pre-1969 era a very small fraction of the foundation population.

Section 4942 imposes costs which significantly outweigh any real gains which it may conceivably afford. It should be repealed.

Short of repeal, the minimum distribution rule should apply with respect to distributions over a far longer period than a single taxable year.

For example, the penalty should apply, if at all, to some given percentage of the excess of the foundation's earnings over its distribution over, say, a 10- or 20-year period. The more rapidly the foundation is expanding its distributions over an appropriately long time horizon, the smaller the proportion of its undistributed earnings which should be subject to tax.

Section 4943 imposes a 5-percent tax on excess business holdings of any foundation in a business enterprise. These holdings mean the amount of stock in a corporation in excess of 20 percent of the corporation's voting stock, reduced by the percentage of the voting stock owned by all disqualified persons.

If following the imposition of the tax the foundation has excess business holdings at the end of the period, a tax of 200 percent of the excess business holdings is imposed. The section obviously imposes strong pressure indeed on the foundation to dispose of excess business holdings within the specified taxable period.

The objectives which 4943 serve are two-fold. One is to prevent concerns with the corporate business whose stock the foundation owns from becoming so great as to divert the foundation management's attention from the charitable activities for which the foundation was created. Second, to prevent the foundation from using the tax free—in-its-hands—income obtained from the corporation to finance the corporation's growth while competing companies must rely on after-tax income for this purpose.

The first objective is largely irrelevant in the case of virtually all large private foundations whose managers and executives devote their energies and time to the demanding business of the foundations. While these managers may well, indeed, they should, have a keen eye on the fortunes of the company or companies whose stock the foundations own, it does not follow that their concern impairs their functioning as foundation managers.

The argument, if it has weight at all, would be meaningful in the case only of small foundations endowed with stock of small companies. In such cases it is difficult to see that the long-term interests of the foundation and of the charities to which it contributes are not well served by the foundation manager's close attention as well to the affairs of the corporate business whose stock the foundation owns. That business, after all, is by assumption an important, if not the predominant, source of funding for the foundation.

The foundation management would be remiss in its conduct of the foundation's affairs if it did not pay close attention to the corporate business and at the same time to improve corporate performance.

The unfair competition argument appears to be somewhat more substantial and somewhat more closely related to the real world.

It is scarcely applicable in the case of the large private foundation and large publicly held corporations in which such foundations often hold stock. The example of potential abuse in this area usually features a corporation's management creating a foundation to operate a subsidiary capitalized by funds deductible as a charitable contribution of the corporation.

This clearly is unrealistic in the case of large publicly held companies. It may be somewhat less farfetched in the case of small closely held companies whose use of funds in such a way would not be subject to challenge by a large number of shareholders. But even so, this is hardly likely ever to have been a prevalent erosion of competition.

It is also difficult to perceive how the absence of a 4943 section would confine opportunities for tax-free sources of finance to one company and preclude the opportunities for any other.

Against these iffy gains from section 4943, one must weigh the solid costs. The principal effects of this section have been to discourage creation of new foundations by the contribution of controlling blocks of stock in a business which the would-be donor has developed, and to force the untimely and unprofitable disposition of stock by the foundations or corporate family shareholders.

In the case of many foundations and corporate shareholders for whom the section was meaningful—the corporations are closely held, and there is a thin market at best for its shares—forced disposition is likely to involve significant capital losses and impairment of the corporation's operations and growth.

Section 4943, in my judgment, should be repealed. It is difficult to identify any serious threat to the economy which would be created in doing so.

Repeal of this section, on the other hand, would eliminate a serious constraint on the financing of new foundations. It would also eliminate an artificial limitation on the portfolio policy of many existing foundations.

Thank you for your attention.

[The prepared statement follows:]

STATEMENT OF NORMAN B. TURE, CHAIRMAN, INSTITUTE FOR RESEARCH ON THE ECONOMICS OF TAXATION

My name is Norman B. Ture,[1] I am Chairman of the Institute for Research on the Economics of Taxation (IRET), a public policy research organization focusing on public economic policies.

The subject of the tax rules applicable to private foundations with which the subcommittee is concerned in these hearings is both broad in scope and complex. My discussion is confined to two of the present law provisions, Sections 4942 and 4943 which, I submit, should be repealed in the interests of allowing private foundations to function more effectively. Section 4942 specified requirements for distribution of a foundation's net income; Section 4943 limits the combined ownership of a business enterprise by a foundation and so-called disqualified persons. In 1973, I prepared a detailed analysis and evaluation of Section 4942, the minimum distribution rule, which was presented to the Committee on Ways and Means by the Ad Hoc Committee on Section 4942.[2] I will, of course, be pleased to provide a copy of that report for the record of this hearing, if the Subcommittee desires. In addition, one of IRET's current undertakings is a set of studies of the provisions in the present tax law pertaining to private foundations. IRET will be pleased to share with the Subcommittee the results of these studies as they become available. With this in mind, my testimony on the occasion will be quite brief.

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[1] The views that are presented here are my own and do not necessarily reflect the views of the Institute for Research on the Economics of Taxation. The title and the name are used for identification purposes only.

Let me preface that testimony with a few summary observations about the role of private foundations in the American economy. It has long been part of the conventional wisdom to characterize the U.S. economy as "mixed," that is, as involving participation by the public sector as well as profit-seeking businesses in organizing production processes, using production inputs to produce and distribute outputs. As members of Congress well know, one of the major issues they confront concerns the proper division of responsibilities between the public and private sectors. Often overlooked or misperceived is the function of private philanthropy, in particular private foundations, in this setting. Largely as a result of the growing conviction in recent years that government has too large a presence in our economic life and that the range and amount of government activity must be curtailed, there has tended to emerge the view that private philanthropic organizations can and should take over responsibilities for activities previously undertaken by government. I believe this to be a mistaken view which, if implemented, would result in seriously reducing the effectiveness of private philanthropy. There are, of course, notable exceptions to this conclusion; governments have assumed over the years many functions and activities which properly belong in the private sector, some of which used to be and would now be quite effectively undertaken by eleemosynary organizations. But to assume that in general the private philanthropic community should and can step in to fill the gap allegedly left by slowing the expansion of government is, I believe, without justification. Private philanthropy should not be perceived as alternative government.

The appropriate preserve of private philanthropic organizations is to engage in activities and to provide services and goods which are essentially private in character but which are not effectively undertaken by profit-seeking businesses. In the general case, these activities cannot be marketed to provide revenues adequate to pay for the capital, labor, and others production inputs they require. This does not mean that the activities are not valuable; it means, rather, that they are of such a character that they cannot be sold on a customer-by-customer basis.

The variety of these activities is enormous, ranging from providing food, shelter, and other support for human derelicts to undertaking the most basic and abstract research in virtually all fields of knowledge. Similarly, the organizations undertaking these activities are extraordinarily diverse.

Unlike government when it moves into a field of activity, private foundations tend to respond quickly to the dynamic changes in demands and opportunities which they perceive. Successes and failures of the activities private foundations support are not measurable in the simple bottom-line terms of profit-seeking businesses. For the most part, however, foundations are quick to identify alternative uses and users of their resources and to rely on a rigorous competition among grantees to assure the most effective and productive uses.

This diversity of activities and services and of the organizations delivering them and the dynamics of the foundation sector are major sources of strength of private philanthropy. Public policy which constricts this diversity or impairs this dynamism imposes a cost which is likely to be very substantial, indeed, even though it can't be readily estimated. For this reason, any public regulatory or tax constraints should require a demonstration of urgent social purpose to be served thereby.

Neither Section 4942 nor Section 4943 serves any really urgent public requirement. The substantial costs they impose are not offset by any signficant, identifiable gains in public welfare.

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[2] Cf. Norman B. Ture, Inc., "The Impact of the Minimum Distribution Rule of Foundations," in Public Hearings on General Tax Reform, Committee on Ways and Means, House of Representatives, 93rd Congress, 15th Session, Part 14, April 9–10, 1973.

SECTION 4942: THE MINIMUM DISTRIBUTION RULE

Section 4942 imposes a tax of 15 percent (initially) on a private foundation's undistributed income defined as the excess of the foundation's net income over its minimum investment return. The latter is defined, for tax years beginning after 1981, as five percent of the fair market value of the foundation's net assets.

Section 4942 was enacted in the Tax Reform Act of 1969 ostensibly for the purpose of eliminating the uncertainty of prior law under which foundations accumulating income in unreasonable amount or over an unreasonably long period might lose their tax-exempt status. Without careful, and meaningful, delineation of "unreasonable," there were no operational guidelines for private foundations to follow in setting their long-range distribution strategies. In practice, it was allegedly found that the loss of tax exemption was inadequate in some cases to constrain accumulation deemed to be excessive and in other cases was far too severe a penalty. And for a foundation a substantial part of whose assets generated no current cash flow, the unreasonable accumulation rule was largely inoperative.

Failure by a foundation to distribute its income was deemed to be an abuse in that the donor of the foundation's assets had received a tax benefit from his charitable contribution deduction but no current benefits, i.e., grants, were received by charities to justify the donor's tax saving. The principle objective of Section 4942, accordingly, was to avert any such "abuse" by requiring private foundations to distribute promptly to charities all of the foundation's earnings.

It must be obvious that the minimum distribution rule is likely to exert a significant constraining influence on a foundation's portfolio policy as well as on its ability to execute what it believes to be an appropriate long-range grant-making strategy. Portfolio policy and grant-making strategy, clearly, are likely to be closely related considerations for foundation management. A constraint on one, more often than not, restricts the other.

There is little *a priori* basis for holding that the optimum distribution policy, with its consequent implications for selection of foundation assets, is one in which all or a substantial part of the returns on the foundation's assets are currently distributed. It should be clear that today's distribution reduces tomorrow's capacity to distribute. For the long term, the principal determinant of a foundation's distributions in any one year should be—and would be, in the absence of government constraints to the contrary—the desired or targeted distribution in a future year, given the rate of return the foundation can earn on its assets. Efficient distribution policy, if the foundation were free to devise it, would be guided by considerations of the specific charitable activities which the foundation wants to support, the present demands of such charities relative to those which may be reasonably anticipated at a future date, the capacity of donees effectively to utilize additional grants currently compared with their use at a later date, and so on. The balance among these and numerous other considerations dictate efficient distribution policy. The mimimum distribution rule does not preclude an efficient distribution policy for all foundations, but it passes belief that it does not signficantly distort that policy for many foundations, hence reduce their capacity to serve over time the purposes for which they were created. If there is a public policy concensus that the demands imposed by charities for private financial support are growing, and are likely to continue to do so, at an accelerating rate, it should be recognized that Section 4942 is likely to be at odds with this objective.

For many foundations, compliance with Section 4942 exerts pressure to reconstitute portfolios in favor of assets with relatively high current yields as opposed to those with strong growth potential. A foundation with a substantial proportion of its assets in the stock of a low-payout, high-growth corporation may very well be required under the minimum distribution rule, to liquidate significant amounts of its assets, while another foundation with a substantial part of its assets in high-payout, low-yield shares in a slower growing company may be under no such constraint. In terms of investment performance and growth in capacity to provide financial support to charities, the first foundation may well be highly superior to the second. The impact of the minimum distribution in such cases is counterproductive. Moreover, if the first foundation's stock is that of a closely-held company for which little or no market exists, the foundation may be put into an impossible position with regard to both effective management of its investments and building the capacity to support charity.

Similar difficulties arise where substantial amounts of the foundation's assets are in real estate on which the cash flow is less than 5 percent of the market value of the property. The investment in this property may very well be superior to any alternative available to the foundation in terms of building capacity for distribution to charities. Yet the minimum distribution rule might very well require the foundation to liquidate these assets and either to replace them with others which are inferior or to reduce permanently their capacity to support charities.

The minimum distribution rule obviously disregards and overrules the variety of charitable giving objectives, the differences in present and prospective grant-making capacity, the differences in present and future demands for grants, and the differing endowments of the foundations. It substitutes a tax consideration for the relevant market determinants of optimum foundation distribution policies. And it imposes these costs allegedly to prevent "abuse" by what must have been in the pre-1969 era a very small fraction of the foundation population.

Section 4942 imposes costs which significantly outweigh any real gains which it may conceivably afford. It should be repealed. Short of repeal, the minimum distribution rule should apply with respect to distributions over a far longer period than a single tax year. For example, the penalty tax should apply to some given percentage of the excess of the foundation's earnings over its distributions over a 10- or 20-year period; the percentage of the accumulated income should be lower the higher the rate of growth in the foundation's distributions. The more rapidly the foundation is expanding its distributions over an appropriately long time horizon, the smaller the proportion of its undistributed earnings which should be subject to tax.

SECTION 4943: EXCESS BUSINESS HOLDINGS

Section 4943 imposes a tax of 5 percent on the excess business holdings of any private foundation in a business enterprise. Excess business holdings of a foundation means the amount of stock in a corporation in excess of 20 percent of the corporation's voting stock reduced by the percentage of the voting stock owned by all disqualified persons. In certain cases where control of the business lies outside the foundation and disqualified persons, the percentage is raised to 35 percent. And if the foundation owns not more than 2 percent of the voting stock, the excess business holding provision does not apply. If following the imposition of the initial tax, the foundation still has excess business holdings at the end of the taxable period, a tax of 200 percent of the excess business holdings is imposed. Section 4943, obviously, imposes very strong pressure indeed on the foundation to dispose of excess business holdings within the specified taxable periods.

The objectives which Section 4943 ostensibly serves are twofold. One is to prevent the concerns with the corporate business whose stock the foundation owns from becoming so great as to divert the foundation management's attention from the charitable activities for which the foundation was created. The second is to prevent the foundation from using the tax-free (in its hands) income it obtains from a corporation to finance its growth while a competing company must rely on after-tax income for this purpose.

It should be clear that the first objective is largely irrelevant in the case of virtually all of the large private foundations whose managers and executives devote their energies and time to the demanding business of the foundations. While these managers may very well (indeed they should) have a keen eye on the fortunes of the company (or companies) whose stock the foundations own, it does not follow that that concern impairs their functioning as foundation managers. The argument, if it has any weight at all, would be meaningful only int he case of very small foundations endowed with the stock of small companies. In such cases, it is difficult to see that the long-term interests of the foundation and the charities to which it contributes are not well served by the foundation manager's close attention as well as to the affairs of the corporate business whose stock the foundation owns. That business, after all, is by assumption an important if not the predominant source of funding for the foundation; the foundation management would be remiss in its conduct of the foundation's affairs if it did not pay close attention to the corporate business and attempt to improve corporate performance.

The unfair competition argument appears to be more substantial and more closely related to the real world. Here, too, it is scarcely applicable in the case of the large private foundation and large, publicly held corporations in which such foundations hold stock. The example of potential "abuse" in this area usually features a corporation's management creating a foundation to operate a subsidiary capitalized by funds deductible as a charitable contribution of the corporation. This clearly is unrealistic in the case of large, publicly held companies. It may be somewhat less far-fetched in the case of small, closely-held companies whose use of funds in such a way would not be subject to challenge by a larger number of shareholders. But even so, this is hardly likely ever to have been a prevalent erosion of competition. Moreover, it is difficult to perceive how the absence of a Section 4943 would confine the opportunities for tax-free sources of finance to one company and preclude these opportunities for another.

Against these very iffy gains from Section 4943 one must weigh the solid costs. The principal effects of this section have been (1) to discourage the creation of new foundations by the contribution of controlling blocks of stock in a business which the would-be donor has developed, and (2) to force the untimely and unprofitable disposition of stock by the foundation or corporate family shareholders. In the case of many of the foundations and corporate shareholders for whom Section 4943 is meaningful, the corporation is closely held and there is a very thin market at best for its shares. Forced disposition, then, is likely to involve significant capital losses and imapairment of the corporation's operations and growth.

Even in those cases in which an adequate market for the stock exists, there are likely to be serious problems in arranging sales of large blocks within the time table called for in Section 4943 without substantial loss. The excess holdings provision puts the foundation management and the disqualified persons on the spot to find just the right window in time for what is, to all intents and purposes, a forced sale, in order to protect the financial interests of both.

Moreover, Section 4943 acts to override the judgments of the foundation managers with respect to portfolio composition. the section ignores the comparative yield, security, and other considerations which should be meaningful in portfolio management and makes the investment policy of the foundation hostage to vague public policy concerns which, for the most part, are absent from the foundation's considerations.

Section 4943 should be repealed. It is difficult to identify any serious threat to the economy which would be created in doing so. Repeal of this section, on the other hand, would eliminate a serious constraint on the financing of new foundations. It would also eliminate an artificial limitation on the portfolio policy of many existing foundations.

Chairman **Rangel**. Mr. Stein.

I might just advise the panel to stay within the 5-minute rule so the Chair does not interrupt the continuity of the testimony.

Mr. Stein.

STATEMENT OF MALCOLM L. STEIN, ESQ., PARTNER, ROBERTS & HOLLAND, NEW YORK, N.Y.

Mr. **Stein**. Mr. Chairman, members of the committee, thank you for the opportunity to testify today.

I am Malcolm Stein. I was a staff attorney in the Office of the Assistant Secretary of the Treasury for Tax Policy from 1969 through 1971. In that capacity I was concerned with both Treasury policy and the drafting of the statute in the entire private foundation area as well as supervising the drafting of all proposed and some of the final regulations.

I am now a member of the firm of Roberts & Holland of New York and Washington, D.C., and I am speaking with a background of an extensive practice in the field of large and small private foundations, operating foundations, and public charities.

I believe I am appearing in the public interest and not on behalf of any client.

H.R. 3043, which was introduced in May and sponsored by many members of your committee, covers three of my suggestions which I strongly support: The easing of the limitations on charitable contributions; abatement of the penalty tax provisions; and also relaxing expenditure responsibility for certain small grants.

Therefore, I will limit my 5-minute summary to my remaining three suggestions.

First, the 2-percent excise tax is somewhere between 8 and 14 times the amount necessary to finance IRS audit activities in the private foundation area.

The tax drains substantial revenues from the philanthropic affairs to which the revenues should be directed. This tax should be eliminated, or failing that, it should be reduced to a 1 percent or perhaps a one-fourth percent level.

Second, the rules restricting excess business holdings discourage gifts and bequests of stock and other business interests to foundations.

These restrictions should be eliminated or at least one single simple set of rules should be enacted requiring foundations to divest themselves of effective control of the business enterprise within a 20-year period without respect to what disqualified persons may hold in the business.

Third, the reporting and expenditure responsibility requirements discourage the making of grants to private foundations and thus inhibit their creation and growth.

These expenditure responsibility requirements should be alleviated by both easing the rules on small grants and also exempting grants to operating foundations from the scope of these rules.

First the 2-percent tax: This tax singles out private foundations from all other charitable organizations, all of which are under the supervision and audit control of the IRS.

In the words of Congressman Conable, in 1977 when the tax was reduced to 2 percent, this tax:

> Does precisely what it ought not to do, because it unnecessarily reduces the flow of foundation funds to hospitals, schools, universities, museums, youth groups, minorities, community programs, and the range of human benevolent activity supported by foundation giving.

The table on page 10 of my testimony I think amply demonstrates that this tax should be eliminated or substantially reduced.

The audit cost of the IRS in 1982 was no more than a maximum of $11.1 million for auditing private foundations. The Council on Foundations' estimate is a $6.7 million audit cost in 1982.

The total tax collected under the 2-percent tax for that year was $93.2 million, between 8 and 14 times the audit cost.

This, I think, amply demonstrates that the tax should be eliminated or reduced substantially, and there should also be a requirement of precise accounting on the part of the IRS for those costs that go into the private foundation area.

In the excess business holdings area, these rules are extremely complex and impose severe hardships on private foundations.

Mr. Chairman and members of the committee, I respectfully suggest that my recommending its elimination is very significant. I have refrained from doing so in the past, including the 1973 hearings before the Senate Finance Committee at which I testified.

I am satisfied now that the self-dealing rules and the 5-percent distribution rule, coupled with the State fiduciary responsibility rules imposed on trustees and directors of foundations, amply protect the distribution of charitable assets to the philanthropic field.

I have no clients interested in this provision. In my view, however, this provision is totally unnecessary to the goal of insuring that assets be devoted to charitable use.

In fact, forced divestiture over the years has reduced the assets available for charitable activities and will continue to do so unless the rule is eliminated. Short of elimination, these provisions should be radically amended to end the differentiation between old and new foundations, to set forth rules which do not depend on the actions of disqualified persons, and to lengthen substantially the period required for divestiture.

The expenditure responsibility rules, with their pre-grant inquiry, investigation and reporting rules, place an administrative burden on foundations that prevent them or discourage them from making many worthwhile grants.

In particular, grants to operating foundations such as museums and libraries are subject to the expenditure responsibility rules. Operating foundations represent roughly 4 percent of the total number of private foundations. They are obligated by the Internal Revenue Code to spend their income and assets directly for their own charitable programs.

They are also required by the form 990-PF to report annually on the maintenance of their status as operating foundations and on their direct charitable involvement. Because of the code requirements and their annual reporting requirements, it would be a sensible relaxation of the expenditure responsibility rules to exempt grants to operating foundations from these rules.

In conclusion, the rules on taxes and penalties for foundations and their managers, as well as rules limiting charitable contributions to foundations, have inhibited their creation and growth and have accelerated their death rate. These recommendations for legislative action would substantially alleviate these conditions.

Thank you.

[The prepared statement follows:]

STATEMENT OF MALCOLM L. STEIN [1]

EFFECT OF THE TAX REFORM ACT OF 1969 ON THE OPERATIONS, VITALITY AND GROWTH OF PRIVATE FOUNDATIONS

I. Introduction

Thank you for permitting me the privilege of testifying before the Subcommittee on Oversight of the Committee on Ways and Means.

Please allow me to introduce myself. I was a staff attorney in the Office of the Assistant Secretary of the Treasury for Tax Policy from 1969 through 1971. In that capacity, I was concerned with both Treasury policy and the drafting of the statute in the entire private foundation area, as well as supervising the drafting of all of the proposed and some final Treasury regulations in that area. I am now a member of the firm of Roberts & Holland, and I am speaking today with the background of an extensive practice in the field of both large and small private foundations, operating foundations and public charities over the past eleven and one-half years.

The provisions of the Tax Reform Act of 1969 relating to private foundations imposed a comprehensive body of law on these organizations for the first time. The viewpoint of Treasury Department officials as to how the foundation provisions would affect foundations' operations, at least from 1969 to 1971 while I was in the Office of the Assistant Secretary of the Treasury for Tax Policy, was not too divergent from the views of State attorneys general and the foundation community.

In general, the Treasury Department viewed most of these provisions as a set of reasonable restrictions on foundation activities, accompanied by flexible sanctions and penalties which are tailored to the extent of the violation. The self-dealing and income distribution provisions of the Act are probably the most necessary limitations placed upon the activities of foundations—they affect the greatest number of foundations and quantum of activities and were the proposals most widely supported by the foundation community in 1969. Of course, the business divestiture requirements and the restrictions on political and grant-making activities also have a substantial impact on the operations of private foundations.

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[1] Attorney (New York and District of Columbia); Formerly Lecturer-in-Law, Columbia University School of Law, 1965–1969; Formerly Attorney-Adviser, Office of Assistant Secretary of the Treasury for Tax Policy, 1969–1971; Partner, Roberts & Holland, New York, New York and Washington, D.C.

As a result of the restrictions imposed on private foundations, as well as the limitations on charitable contributions to those organizations, only one-third as many new foundations were established during the 1970's as were established during the 1960's. See Section-by-Section Analysis of H.R. 3043, to Eliminate Tax Disincentives for Gifts to Private Foundations, introduced by Rep. Barber Conable, May 18, 1983. There has also been a precipitous drop in both gifts and bequests to private foundations.

Five of the major reasons for the inhibited birth-rate of private foundations are as follows:

(1) Current law discourages gifts to private foundations because it affords such gifts substantially less favorable income tax treatment than gifts to public charities.

(2) The 2 percent excise tax on net investment income is more than double the level necessary to finance the audit activities of the Internal Revenue Service and drains substantial revenues from the philanthropic activities to which they should be directed.

(3) The rules prohibiting excess business holdings of private foundations discourage gifts and bequests of stock and other business interests to foundations, which must strain to comply with an unnecessarily burdensome and complex set of rules when such gifts and bequests are nevertheless made.

(4) The reporting and expenditure responsibility requirements imposed on grant-making activities discourage the making of grants to private foundations and thus inhibit their creation and growth.

(5) The penalty taxes imposed on foundations for inadvertent violations involving activities undertaken in good faith are also an inhibiting factor in the formation of foundations and the willingness of individuals to participate in their affairs.

The future birth rate of foundations will also be affected by whether the private foundation rules introduced in the 1969 Act will be extended by additional legislation to encompass public charities as well. Although some changes affecting public charities may be merited, neither Congress not the Treasury Department has apparently reached any final conclusions as yet. As a general rule, the discipline of public support has proved to be an adequate restraint on the activities of public charities. There is no clear need for such specific rules as the self-dealing, charitable distribution, business divestiture, and taxable expenditure rules as are present in Code sections 4941 through 4945 for private foundations. The condition arising at law generally that the public charity's property be devoted to charitable use will ordinarily be sufficient.

II. Recommendations

The current factors inhibiting the birthrate and growth of private foundations, and thus the availability of additional assets for charitable purposes, could be eliminated or substantially lessened by the enactment of the following reforms:

(1) Eliminate the distinctions between gifts to private foundations and public charities: (a) permit deductions for gifts of appreciated property to private foundations up to 30 percent of adjusted gross income and for gifts of cash to private foundations up to 50 percent of adjusted gross income; (b) do not reduce gifts of appreciated property to private foundations by a portion of the appreciation; and (c) permit carryovers of excess contributions for a five-year period.

(2) Eliminate the excise tax on net investment income in order to place private foundations on an equal footing with public charities or, failing that result, at least reduce the tax to a one percent rate (or lesser rate) more in line with the IRS audit cost.

(3) Eliminate the restrictions on excess business holdings in Code section 4943, or at least enact one simple set of rules for all foundations providing that a private foundation must divest itself of effective control over a business enterprise within twenty years after such control results from a gift or bequest of an interest in the business enterprise, in every case disregarding any interest in the business enterprise held by disqualified persons.

(4) Alleviate the expenditure responsibility requirements of Code section 4945 by (a) exempting grants to operating foundations from the record-keeping, investigation and reporting requirements of section 4945(d)(4) and 4945(h); and (b) amending the law to provide that the expenditure responsibility requirements do not apply to a grant of less than $10,000 to one grantee in a given taxable year when made by a private foundation (and any related foundations) having less than $1 million of

assets (or perhaps exempting such a grant regardless of the size of the granting foundation, as long as the grantee reports at least annually to the granting foundation as to the use of the granted funds).

(5) Enact an overall provision giving the Secretary of the Treasury authority to abate the first-level penalty taxes under Code sections 4941 to 4945 in cases in which he determines that the violation of the private foundation rules was due to an act or omission to act made in good faith and corrected within the statutory correction period.

III. Discussion

A. Eliminate limitations on charitable contributions.—A prospective creator of a new private foundation or donor to an existing foundation must not only consider the administrative burdens, the program restrictions, and the 2 percent excise tax and charitable distribution requirements imposed on the foundation, but he or she must also confront three other rules which directly discourage the creation or growth of the foundation:

(1) A donor may make contributions of appreciated property or cash to a public charity up to 30 percent or 50 percent of his or her adjusted gross income, as contrasted to 20 percent in the case of a non-operating private foundation.

(2) There are no carryovers to future years of excess contributions made to a non-operating private foundation.

(3) Gifts of appreciated property to private foundations (other than operating foundations or conduit foundations) are reduced by a portion of the appreciation in value. Yet most contributions to foundations prior to the 1969 Act consisted of appreciated property, according to the 1969 Peterson Commission report to the Senate Finance Committee. See Foundations, Private Giving, and Public Policy, Report and Recommendations of the Commission on Foundations and Private Philanthropy 165–168 (1970). Hence, lifetime giving to private foundations has been severely curtailed by the operation of this 1969 rule.

Contributions to private foundations should be treated in the same fashion as donations to public charities. A foundation is, in effect, a source of funds to support a number of charities and philanthropic programs on a year-by-year basis according to the ever-changing needs of society. Because foundations represent an assured source of charitable support for future needs, individuals should be permitted the same income tax deduction for a gift to a private foundation as for a contribution to a public charity.

B. Eliminate or reduce the 2 percent tax.—The legislative history of the 1969 Act indicates that the ultimate rationale of Congress for enacting the excise tax on net investment income was based on the ability of private foundations to pay part of the cost of government or the desirability of imposing an audit fee on foundations. Nevertheless, it is clear that this tax singled out private foundations from all other charitable organizations, each of which has the ability to pay and is subject to audit by the Internal Revenue Service. A more serious objection to this tax is the fact that it directly reduces the funds available for charitable distribution, thereby placing the ultimate burden for the tax on those charities which would otherwise receive the funds as grants. At the very time that charitable funds are needed in increasing measure, the 2 percent tax removes millions of dollars from the charitable stream.

The House Ways and Means Committee Report dated January 19, 1978, on H.R. 112 (to reduce the excise tax on investment income of private foundations from 4 percent to 2 percent) recognized that this tax reduces the minimum amount that private foundations are required to spend or grant for charitable purposes and that the tax actually has reduced charitable expenditures. In connection with this bill, which was enacted into law effective for taxable years beginning after September 30, 1977, Rep. Barber Conable stated that this tax "does precisely what it ought not to do" because "it unnecessarily reduces the flow of foundation funds to our hospitals, schools, universities, museums, youth groups, minorities, community programs, and the range of human benevolent activity supported by foundation giving." Rep. James Corman added that the excess revenue from the tax "could be returned to foundations to flow through to scholarship recipients, medical research programs, and other projects that meet the needs of the community as well as the individual." See BNA Daily Report for Executives G-1, July 19, 1977.

Reduction of the excise tax on net investment income to a 1 percent level (or lower) is justified by the following statistics (listed in millions of dollars) published by the Internal Revenue Service:

Fiscal year	IRS cost of auditing foundations	Total tax collected	Tax at 1 percent level
1972	12.9	56.0	14.0
1973	12.3	76.6	19.1
1974	(1)	69.8	17.4
1975	(1)	63.8	15.9
1976	(1)	59.8	14.9
1977	(1)	78.6	19.6
1978	[2]10.4	84.0	21.0
1979[3]	[2]10.7	63.2	31.6
1980	[2]10.0	65.2	32.6
1981	[2]11.5	84.0	42.0
1982	[2]11.1	93.2	46.6

[1] Figures unavailable. Rep. Conable, in the July 1977 speech quoted above, estimated that the IRS costs of supervising foundations were then running at a level of approximately $10 million per year.

[2] Estimates based on IRS costs in Employee Plan and Exempt Organization area derived from 1979 Annual Report of the Commissioner of Internal Revenue 71 and Hearings before a Subcommittee of the House Committee on Appropriations, 97th Cong., 2d Sess., Part 1, at 969 (1982). Estimate in each year of IRS cost in Exempt Organization area is assumed to be one-half of the total cost, although actual figure is probably less. Estimate of IRS cost of auditing foundations is assumed to be one-third of the Exempt Organization cost, although figure is probably less because only 15 percent of the total audit effort of the IRS in the Exempt Organization area in the past several years relates to private foundations.

[3] First year of 2 percent tax rate.

Hence, the 2 percent tax should be eliminated or set at a level (no more than 1 percent or perhaps one-quarter to one-half of 1 percent) closer to the actual auditing and supervisory costs incurred by the Internal Revenue Service.

C. Eliminate or Lessen Restrictions on Excess Business Holdings.—The following discussion of the limitations on excess business holdings does not recount the statutory rules in detail. It proceeds from the strong feeling among Treasury personnel in 1969 to 1971 that the self-dealing rules and the charitable distribution requirements would have been sufficient to guarantee the devotion of assets and the attention of foundation managers to charitable endeavors, without the need for the enactment of Code section 4943. Indeed, nearly twelve years of dealing with private foundation problems and programs in my private practice subsequent to the 1969 Act have only reinforced this view.

The current statute is extremely complex and often imposes severe hardship on private foundations which are not involved at all in the operations of a business in which they may have substantial interests. These inequities result, in part, from the fact that (a) excess business holdings include the holdings of disqualified persons who may have no connection with the foundation, may even be estranged from the foundation managers, and may give no notice to the foundation that they are acquiring such holdings; (b) immediate and automatic penalties apply whenever excess business holdings arise; and (c) there may be no market for the stock or other business holdings, or sales may be restricted by Federal or State securities laws.

These burdensome and inequitable rules should be eliminated. They are so complicated that the Internal Revenue Service is still struggling, fourteen years later, to resolve certain aspects of the Regulations in a fair and reasonable manner. Short of elimination, these provisions should be radically amended to end the differentiation between old and new foundations, to set forth rules which do not depend on the actions of disqualified persons, and to lengthen substantially the period required for divestiture. One suggestion would be to provide that a private foundation must divest itself of effective control over a business enterprise within a twenty-year period, without taking into account any interest in the business held by disqualified persons. At a minimum, a private foundation should not be subject to the imposition of a penalty tax on excess business holdings because of a purchase of stock by a disqualified person, unless the foundation has notice or reasonably could be expected to have notice of such purchase and does not reduce its own holdings sufficiently within a reasonable period of time (at least six months, extended by any period during which the foundation is prohibited by law or otherwise from disposing of its holdings).

D. Alleviate expenditure responsibility requirements.—Under current law, a private foundation which makes a grant to an organization which is not a public charity must comply with detailed expenditure responsibility requirements. These requirements include making pre-grant investigation of the grantee, executing a written grant agreement, obtaining periodic accountings from the grantee, and filing annual reports with the IRS on the use of the granted funds. This administrative burden discourages foundations from making many worthwhile grants.

In particular, grants to operating foundations (which administer their own direct charitable programs) are currently subject to the expenditure responsibility rules. Operating foundations represent roughly four percent of the total number of private foundations. See Hearings before the Subcommittee on Foundations of the Senate Committee on Finance, 93d Cong., 2d Sess. 115 (June 3, 1974). Operating foundations are obligated to devote their income and assets directly to their charitable program. Moreover, they must themselves report annually to the IRS that they are maintaining their direct charitable involvement. Many operating foundations, such as museums and libraries, fall into the private foundation category only because income from their endowment prevents them from being publicly supported under the Code and Regulations. Because of the direct charitable involvement of operating foundations, their own reporting requirements, and the general doctrine that their property be devoted to charitable use, it would be a sensible relaxation of the expenditure responsibility rules to exempt grants made by non-operating private foundations to operating foundations.

The extent to which the expenditure responsibility requirements are burdensome in general depends in large measure on the staff and financial resources available to a foundation. For all foundations the added paperwork alone is time-consuming and costly. Smaller foundations, in particular, may forego making many grants which entail the exercise of expenditure responsibility because of the disproportionate expense involved. The reporting provisions and restrictions on foundations enacted in 1969 probably made it uneconomical for many very small foundations to continue their operations. Thus, there was an initial surge of foundation terminations in the first few years after the enactment of the 1969 Act. Some small foundations, instead of terminating by distributing all of their net assets, became affiliated with community foundations or other public charities or qualified as conduit organizations. Other small foundations have developed economies of scale by engaging with one another in various types of joint service arrangement in order to minimize the burdens of the statutory requirements.

At a minimum, the law should be amended to exempt a grant of less than $10,000 to one grantee in a given taxable year when made by a private foundation (and any related foundations) having less than $1 million of assets. A less limited exemption could, perhaps, afford larger foundations the same privilege, perhaps coupled with the requirement that the grantee report at least annually to the granting foundation as to the use of the granted funds (and that the granting foundation take appropriate action when it learns of a diversion from the charitable purposes of the grant).

E. *Abate first-level penalty taxes.*—Existing law automatically imposes a first-level penalty tax on all violations of the private foundation rules. Imposition of such taxes where the violation is due to an error or omission made in good faith and corrected within the statutory period does not contribute to increased compliance with the rules and thus needlessly reduces resources available for charitable activities. Consideration should therefore be given to the enactment of a provision giving the Secretary of the Treasury authority to abate the first-level penalty taxes in such a case. H.R. 3043, introduced on May 18, 1983 and sponsored by four members of the Committee on Ways and Means, contains such a provision as well as others similar to some of the recommendations made herein.

IV. Conclusion

The Treasury Department and the Internal Revenue Service have relied heavily upon the cooperation of the attorneys general and the foundation community in the years following the enactment of the 1969 law. Every effort possible has apparently been made in the Regulations to provide for maximum flexibility within the statutory limits, without any desire or purpose to limit the scope of proper foundation activities in any way. The Regulations have developed rules which generally offer certainty, are conducive to fair enforcement, and can be administered with assurance that they comply with Congressional intent. Nevertheless, the rules regarding taxes and penalties on foundations and their managers, as well as the provisions limiting the deductibility of charitable contributions to private foundations, have inhibited their creation and growth and have accelerated their death rate. The recommendations for legislative action made herein would, if enacted, substantially alleviate the deleterious effects of the current statutory rules.

Chairman **RANGEL**. Mr. DioGuardi.

STATEMENT OF JOSEPH J. DioGUARDI, TAX PARTNER, ARTHUR ANDERSEN & CO.

Mr. DioGuardi. Thank you, Mr. Chairman. I will present an abbreviated version of the statement I have submitted for the record.

Chairman Rangel. Without objection, the full statement will appear.

Mr. DioGuardi. I am Joseph DioGuardi, a tax partner in Arthur Andersen & Co., the large accounting firm, and I have firm-wide responsibility for the tax aspects of nonprofit organizations and for charitable giving. Our clients include over 3,500 charitable-type organizations, many of which are private foundations.

I am representing the views, opinions, and insights of the partners of my firm; I am not appearing at the request or employ of any Arthur Andersen client.

I might add I am an active volunteer in several significant charitable organizations in the New York area, two of which operate in the Bronx, and actively involved in fundraising problems, so I bring a volunteer view to these proceedings.

We would like to present two concepts based on our own experience in this area.

First, there are really many different types of private foundations, and the sanctions developed to prevent abuse in one type act as unnecessary deterrents in the other types.

Second, even where the sanction is properly matched to the type of organization, it may be too harsh and create more difficulties than it solves by reducing private philanthropy.

What is the case for treating different private foundations differently?

I would like to comment on the various types of foundations that I have not heard mentioned today.

There are family foundations, large multipurpose foundations, corporation foundations, community foundations, passthrough foundations, operating foundations, and satellite foundations formed by public charities.

I would like to suggest, therefore, that the generic use of the term "private foundation" is inappropriate when analyzing the history, current status, and future potential of such organizations, whether for their abuses or for their good works.

Perhaps the most important type and one most susceptible to abuse is the family foundation. This is an organization founded by a family to express its philanthropic beliefs. The family accordingly not only funds this foundation, but it is usually active in its management programs.

The sanctions, if any, most appropriately applied to the family foundations would center around rules pertaining to excess business holdings and self-dealing because of the individual control inherent in this type of foundation.

On the other hand, in our experience, the rules that have caused the greatest burden to the continued existence and formation of the family foundation center around the onerous and expensive recordkeeping, public inspection, and tax reporting requirements of the 1969 act. The relatively smaller size of these foundations and the high proportion of their grants to public charities do not warrant these administrative burdens.

A second type of foundation, the large multipurpose foundation, is similar to the family foundation in that it is usually founded and funded by a single family. There are major differences in that the family usually does not maintain involvement. All management and program activity are controlled and implemented by unrelated boards of directors and employed staff.

The typical programs are more diverse and larger than those of the family foundations. In fact, a large multipurpose foundation is similar to a public charity in many respects. But it does not enjoy broad public support because it doesn't seek it.

Since these foundations are controlled for the most part by unrelated and prominent boards of directors, their susceptibility to problems related to self-dealing and jeopardy investments are minimal.

In our view, these sanctions are unnecessarily restricting the investment programs of these foundations relative to public charities. Concerns expressed about these foundations prior to 1969 in connection with certain grant making to individuals and partisan political activists may warrant continuation of certain reporting rules for the large multipurpose foundations.

A corporation foundation is one that is founded and funded by a corporation, usually a public corporation, rather than an individual, and the difference is important in designing antiabuse sanctions. Currently they are treated the same, however, for tax purposes.

This type of foundation is usually formed by larger publicly held corporations which are already subject to much public scrutiny, to serve as focal point for their charitable activities affecting their business communities and the public at large.

They are also vehicles for currently employed and retired executives to apply their management skills to community problems, and as such, act as public responsibility companies. They should be treated the same as public charities and not be subject to any special sanction.

There are many smaller foundations that have combined into community foundations. They lose their private foundation taint. We don't know if this was the intended effect, but in any case, community foundations serve a very useful purpose and should continue their public charity status.

There are other special categories of foundations, such as pass-through foundations that pass money through to public charities. There are operating foundations that are, as Mr. Stein mentioned, directly involved in the charitable communities. We believe these should be treated as public charities for all purposes.

Finally, there are foundations that are set up by public charities, the so-called satellite foundations. There are complex rules under 509(a)(3) that these organizations must apply to get public charity status. We believe they should be treated as public charities for all purposes once set up.

The importance of foundations and the case for easing sanctions: It is important to realize that at this time the Government is cutting back in its direct support of charitable activity and the current administration is calling on a major return to voluntarism. This presents a challenge to find new ways to engage the private sector in philanthropy.

Since private foundations at the least encourage and promote charitable giving and activity in charities, the law should be changed to ease some sanctions on them, thereby increasing the financial and human resources committed to charitable activities in our communities.

OUR RECOMMENDATIONS

We believe that the private foundation provisions should be modified. First, the area of perceived abuse has been overemphasized. In our view, there were relatively few abuse situations since the 1969 act, and, in general, the entire superstructure is based more on the fear of potential abuse than on actual evidence of it.

Two, assuming the need for sanctions, they should be fine tuned to avoid overkill and made applicable only to that type of foundation susceptible to the abuse.

We have many specific recommendations which are in our written statement, and I will defer to the record on those.

CONCLUSION

In summary, we believe that private foundations play a vital role in our society. Accordingly, we suggest the law be modified to encourage private foundations by treating them more like publicly supported charities.

First, there should be a recognition that the term "private foundation" covers a diversity of organizations and only those types susceptible to abuse should be subject to sanctions.

Second, the sanctions, including related excise taxes, should be imposed on actual abuses rather than in situations where the possibility of abuse exists such as with self-dealing, excess business holdings, jeopardy investments, and certain expenditures.

Thank you for this opportunity to testify.

[The prepared statement follows:]

STATEMENT OF JOSEPH J. DIOGUARDI, C.P.A., TAX PARTNER, ARTHUR ANDERSEN & CO.

Mr. Chairman and other members of the subcommittee: My name is Joseph J. DioGuardi. I am a partner in Arthur Andersen & Co. with firm-wide responsibility for the tax aspects of not-for-profit organizations and charitable giving. Arthur Andersen & Co. is a large, international accounting, tax and management information consulting firm. We have substantial experience in the tax economics of not-for-profit organizations, including private foundations, and work closely with their founders, donors, and administrators. Indeed, in 1969–1970 we were requested by the Peterson Commission on Foundations and Private Philanthropy to undertake a survey of private foundation activities in conjunction with the American Institute of Certified Public Accountants. Our clients include over 3,500 charitable type organizations, many of which are private foundations.

I am representing the views, opinions and insights of the partners of my Firm. I am not appearing at the request or the employ of any Arthur Andersen & Co. client.

INTRODUCTION—WHAT IS A PRIVATE FOUNDATION?

When the term "private foundation" was first developed in connection with the Tax Reform Act of 1969, it was applied broadly to many diverse types of organizations. Indeed, the definition of a private foundation found in Section 509(a) of the

Internal Revenue Code encompasses all organizations described in Section 501(c)(3) with the exception of those organizations listed in Section 509(a). The exceptions generally fall into two categories. First, there are organizations which, by their very nature, are treated more favorably under the tax law—churches, schools, hospitals, medical research organizations, organizations benefiting state and municipal colleges, governmental units and organizations testing for public safety. Secondly, there are organizations that enjoy broad financial support from the public, or from their own exempt activities, or are in a designated support relationship with one or more of the organizations previously mentioned. All other charitable organizations are tainted as private foundations.

The word "taint" was used deliberately because the expressed purpose for delineating the catagory of private foundations was to treat them in a far more disadvantageous manner compared to nonprivate foundations (to which we can refer as public charities for sake of simplicity). Basically, the sanctions imposed on private foundations include an excise tax on their net investment income, a lower percentage contribution limit for their donors (with no carryover available), a reduction in the deduction allowed for gifts of appreciated capital gain property, and excise taxes on self-dealing, excess business holdings, proscribed expenditures, income distribution requirements and jeopardy investments.

The reason for these sanctions was that private foundations, being subject to more control by individuals than are public charities, could be used to satisfy private purposes not intended by the Internal Revenue Code; indeed, there were several cases of abuse discussed by members of Congress prior to the enactment of the 1969 Act. Typically, these abuses involved taxpayers who obtained a charitable deduction for funds beneficially used, retained or controlled by them.

We would like to present two concepts, based on our experience and practice in this area. First, there are really many different types of private foundations, and the sanctions developed to prevent abuse in one type act as unnecessary deterrents to the other types. Secondly, even where the sanction is properly matched to the type of organization, it may be too harsh and create worse ills than the perceived abuses by failing to encourage private philanthropy to its fullest extent through private foundations.

DISCUSSION

The case for treating different private foundations differently.—As mentioned before, there are different types of private foundations and the generic use of the term foundation is inappropriate when analyzing the history, current status and future potential of such organizations, whether for abuses or for their good works.

Perhaps the most important type and the one most susceptible to abuse is the family foundation. This is an organization founded by a family to express its philanthropic beliefs. The family, accordingly, not only funds this type of foundation but is also usually active in its management and programs. The sactions, if any, most appropriately applied to the family foundations would center around the rules pertaining to excess business holdings and self-dealing because of the individual control inherent in this type. On the other hand, in our experience, the rules that have caused the greatest burden to the continued existence and formation of the family foundation center around the onerous and expensive recordkeeping, public inspection and tax reporting requirements of the '69 Act. The relatively smaller size of these foundations as well as the relatively high proportion of grants to public charities do not warrant these administrative burdens.

A second type of foundation, the large multipurpose foundation, is similar to the family foundation in that it is usually founded and funded by a single family. There are major differences, however, in that the family usually does not maintain involvement; all management and program activities are controlled and implemented by unrelated boards of directors and employed staff. The typical programs are more diverse and larger than those of family foundations. In fact, a large multipurpose foundation is similar to a public charity in many respects, but does not enjoy broad public financial support. Since these foundations are controlled, for the most part, by unrelated and prominent Boards of Directors, their susceptibility to problems relating to excess business holdings, self-dealing and jeopardy investments, are minimal. In our view, these sanctions unnecessarily restrict the investment programs of these foundations relative to public charities. The concerns expressed about a few of these foundations prior to 1969 in connection with certain grant-making to individuals and partisan political activities may warrant the continuation of the reporting and disclosure rules for large multipurpose foundations.

A corporation foundation is one that is founded and funded by a corporation rather than by individuals. This difference is of importance in designing anti-abuse sanctions since the motivations of corporate donors are quite different. Yet, currently, they are treated the same for tax purposes. This type of foundation is usually formed by larger publicly held corporations, which are already subject to much public scrutiny, to serve as a focal point for their charitable activities affecting their business communities and the public at large. They are also vehicles for currently employed and retired executives to apply their management skills to community problems and, as such, act as public responsibility companies which should be treated the same as public charities and not subject to any special sanctions.

Many relatively smaller private foundations can be combined and run under one umbrella. In this way, they can be classified as a community foundation and, thereby, lose private foundation taint. Indeed, after the 1969 Act, many family foundations were forced to take this step to continue some semblance of their former charitable activities. This, however, may have been the right answer for many of them since, in doing this, the very character of the individual component foundations changed. A single board of directors, in effect, now controls and directs the many charitable programs once carried on by the individual foundations, if the community foundation elects to continue such programs. Community foundations, however, are usually organized emphasizing community interests rather than pursuing disparate individualistic charitable purposes and, for this very reason, should continue to enjoy public charity status.

There are special categories of foundations that are treated as public charities for certain purposes and as private foundations for other purposes. One type, a pass-through foundation, serves as a conduit for monies between donors and public charities. In our view, this type should have no sanctions applied to it if it actually distributes the requisite amount to qualified public charities. Another type, an operating foundation, runs charitable programs directly as opposed to giving grants to other charitable organizations for such programs. Because direct donor and staff involvement is so high in this relatively scarce type of foundation, full public charity status should be extended to them in order to promote personal involvement in charitable activities.

Finally, there are foundations that are formed by public charities, sometimes referred to as satellite foundations. Where these types meet the support, control and operational tests of Section 509(a)(3), they are, themselves, granted public charity status. Where they fail to meet these highly technical and narrowly construed tests, they become unnecessarily subject to all of the private foundation sanctions.

The case for easing sanctions: The importance of private foundations.—Contributions to charitable organizations are tax deductible within certain limitations. The rationale for this indirect government support of charitable organizations is that not only does the government believe that their functioning is important and should be supported but that, were they not to perform their exempt purposes, the government would need to perform them itself. It is also important to realize that, at this time, the government is cutting back in its direct support of charitable activities and the current administration is calling on a major return to volunteerism. This call presents a challenge to find new and better ways to engage the private sector in philanthropy.

Since private foundations at the very least encourage and promote charitable giving and activity, the law should be changed to ease some of the sanctions on them thereby increasing the financial and human resources committed to charitable activities.

Benefits of private foundations, in particular.—Private foundations have the potential for innovation and experimentation. Many public charities, by their very size and the conservatism of their boards, usually can only pursue projects once they have passed a certain level of development. Private foundations, both family and corporation types, are flexible and responsive. They can process grant applications and make funds available rapidly. This can often make a great difference in projects, such as in rapidly deteriorating communities and on programs for hard pressed minorities, where there is a great toll in human suffering because of delays in developing solutions.

Capital formation for charitable purposes is another unique attribute of private foundations. They serve as a leveling device for both individuals and corporations in that funds may be contributed and deducted in good economic times, allowing for charitable resources in future years when the economy may be suffering and charitable funds are needed more than ever to make up a shortfall in government spending on social welfare programs. Thus, foundations insure a fairly continuous flow of funds for charitable purposes even in economic times where individuals and corporations must cut back their contributions and the government must cut back on spending.

Finally, it should be noted that foundations involve their donors in the charitable process. Both individuals and corporations that establish and administer foundations become more sensitized, in general, to charitable needs.

RECOMMENDATIONS

We believe the private foundation provisions should be modified. First, the area of perceived abuse has been overemphasized. In our view, there were relatively few abuse situations before the '69 Act and the entire superstructure was apparently based more on fear of potential abuse than actual evidence of it. Secondly, assuming the need for sanctions, they should be fine-tuned to avoid overkill and be made applicable only to that type of foundation susceptible to the abuse. Several specific recommendations follow:

"The definition of a private foundation should completely exclude certain types of charitable entities that are clearly not the types of tax-exempt organizations Congress was concerned would potentially abuse their status. Although the Section defining private foundations includes an exception for organizations that support public charities and similar organizations (Section 509(a)(3)), this exception has been narrowly construed by Treasury regulations and the Internal Revenue Service. Many public charities use supporting organizations for special purpose fund-raising activities, or administrative purposes, and find it difficult to meet the rigorous percentage of support requirements to qualify them as public charities. Enacting a provision to liberalize and simplify the application of Code Section 509(a)(3) would reduce the burden of forming and administering numerous bonafide public charities and their related support organizations. Similarly, pass-through and operating foundations should be treated as public charities for all purposes.

"There should be a complete parity between the tax treatment of contributions to private foundations and public charities. The 20 percent limit certainly discourages most individuals from making the significant donations needed to establish or continue private foundations. It also may discourage contributions to public charities because of the complex interplay between the 50 percent limitation and the 20 percent limitation when both types of gifts are made in one year. Depriving individuals of a carryover is needlessly punitive and also discourages this important form of philanthropy. Finally, many private foundations were established with stock from entrepreneurs, since this forms the bulk of their wealth. Depriving them of the full benefit of these contributions by reducing the deductible amount by 40 percent of the unrealized gain serves to discourage the formation of new family and corporate foundations. A more sophisticated argument for parity rests on the fact that some foundations may seek to expand by attracting donations from outside the founder group and can eventually become public charities. The disadvantageous contribution tax rules discourage this transformation.

"The self-dealing rules imposed upon disqualified persons should be modified to return to fair market value and prudent man standards. The current rules heavily penalize foundations by absolute prohibitions. In some cases, a "self-dealing" transaction may be extremely beneficial to the charitable purpose of the foundation and should be allowed. This is certainly prevalent in other sections of the law where arm's-length valuation and objective standards are used.

"The excess business holding rules that severely limit the holding of business interests should be liberalized considering that many foundations were organized through contributions of large blocks of stock that provided income to implement charitable activities. A forced disposition would not always serve the best interests of the public because stockholdings in a privately held business may be a more attractive and prudent investment. At the least, the transitional rule allowing the sale of excess holdings at fair market value to disqualified persons without self-dealing implications should be reinstated.

"There should be a tax parity with public charities. The excise tax on net investment income is really an income tax that reduces the amount of funds available for charitable purposes and runs contrary to the entire underlying philosophy of tax exempt organizations. Excise taxes on prohibited transactions also primarily hurt the charitable recipients of foundations. Reporting and other administrative burdens should be eased, especially for the smaller foundations. The requirement for public inspection and more detailed tax reporting should be simplified."

CONCLUSION

In summary, we believe private foundations play a vital role in our society. They not only channel private sector funds to the public good but they do so in amounts and ways that could not be duplicated by either public charities or the government.

Accordingly, we suggest that the law be modified to encourage private foundations by treating them more like publicly supported charities. To the extent that sanctions must be imposed to avoid abuse of their tax exempt status, we believe such sanctions should be redrafted. First, there should be a recognition that the term private foundation covers a diversity of organizations, and only those types susceptible to abuse should be subject to any sanctions. Secondly, the sanctions, including related excise taxes, should be imposed on actual abuses rather than in situations where merely the possibility of abuse exists, such as with self-dealing, excess business holdings, jeopardy investments and certain proscribed expenditures.

I would like to thank you for giving us the opportunity to testify.

Chairman RANGEL. Mr. Hayes.

STATEMENT OF J. STODDARD HAYES, JR., VICE PRESIDENT, WILMINGTON TRUST CO., MEMBER, TRUST DIVISION TAXATION COMMITTEE, AMERICAN BANKERS ASSOCIATION

Mr. HAYES. Mr. Chairman, members of the subcommittee, I am J. Stoddard Hayes, a member of the Taxation Committee of the Trust Division of the American Bankers Association. I am also a vice president of Wilmington Trust, in Wilmington, Del. John H. Butala, consultant with Ameritrust in Cleveland, Ohio, accompanies me.

Four thousand of the American Bankers Association members act as professional trustees, oftentimes for charitable trusts classified as private foundations. In the last 13 years, it has become clear that the 1969 act's system of regulating charities imposes an unnecessary and extremely costly burden on private philanthropy, particularly charitable trusts.

The purpose of our testimony today is to draw your attention to the substantial burdens imposed on charitable trusts, specifically the reporting requirements and most specifically the form 990-PF; further, to suggest some better ways to satisfy the Government's need to know.

We have submitted a detailed statement for the record and I would like to summarize that at this time.

Chairman RANGEL. Without objection.

Mr. HAYES. In our experience, it takes between 5 and 7 hours for an experienced professional to prepare even the simplest form 990-PF, regardless of the size of the trust in question.

In addition, much of the information required by the form is difficult to obtain. Monthly evaluation of fund assets valued at high, low or mean is not available in any commercial system. Grantmaking institutions must obtain certification that grantees are public charities, or be able to demonstrate that they took precautions to ensure that grants were expended for the intended purposes.

In some cases, trustees must make an independent determination that the recipient's legal entity, a separate organization, does not have any discriminatory policies or practices.

Each charitable trust must advertise publicly each year to say that its books are open for public inspection, even if there is no discretion in the way the trustee must distribute the income.

Consequently, and based on our experience, the minimum cost of obtaining such data and filing a return annually is about $1,150. That excludes any cost for compensation to the trustee.

If you work backwards from that number and you assume that the maximum administrative cost in an efficiently run charitable trust shouldn't be more than 10 percent of income, you can see that trusts over $400,000 can afford to pay their own costs; trusts between $200,000 and $400,000 can afford to pay for the 990-PF preparation but cannot afford actual compensation to the trustee based on 5 percent of income; and trusts of less than $200,000 cannot afford to pay their trustee and further cannot afford even to pay for the preparation of the 990-PF.

Due to these increased costs, our member banks have seen a marked decrease in creation of charitable trusts since enactment of the 1969 act. One typical large corporate fiduciary administers 29 foundations, only one of which was established since 1969.

In our experience, funds that are no longer left to charitable trusts are either passing to large public charities or, for private purposes, to nonexempt individuals.

We are suggesting a two-pronged approach to this problem. First, in certain cases, what we consider the low risk of abuse cases, we would suggest substituting for the form 990-PF a form 1041 fiduciary income tax return accompanied by the trustee's certification that it is not engaged in any prohibited transactions and has distributed all its income.

The types of charitable trusts which we feel fall within this category are trusts with annual receipts of less than $25,000, trusts which have not received contributions within the last 5 years or trusts which would qualify as 509(a)(3) supporting organizations but for the fact they cannot meet the so-called integral part test.

As to remaining charitable trusts, we would suggest filing a simplified form 990-PF, a form which would eliminate public notice requirements where the income distributions are fixed by the governing instrument; eliminate the computation of adjusted net income, which was made no longer necessary by the 1982 act; replace the so-called balance sheet, which is really a cash flow statement with a schedule of assets and liabilities; reduce the valuations from monthly to quarterly or even annually for very small trusts; change the prescribed valuation method from high, low or mean to any reasonable method consistently applied by the trustee; and raise the minimum for expenditure responsibility from $1,000 to $2,500.

Mr. Chairman, I would like the record corrected to reflect a typographical error on page 16 in our statement. It is $2,500, not $25,000.

Chairman RANGEL. Without objection.

Mr. HAYES. Thank you.

Finally, to permit the Commissioner to waive penalty and excise taxes where the error was due to reasonable cause and not negligence or willful neglect.

In conclusion, private philanthropy through the use of small charitable trusts has advantages over large endowments and should be encouraged. We would encourage Congress to take the steps which we have suggested to ease the administative burdens imposed on charity by the 1969 act.

Thank you.

Chairman RANGEL. Thank you, Mr. Hayes.

[The prepared statement follows:]

STATEMENT OF J. STODDARD HAYES, JR., ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. Chairman and Members of the Subcommittee: My name is J. Stoddard Hayes, Jr. I am a member of the Taxation Committee of the Trust Division of the American Bankers Association and Vice President of Wilmington Trust Company in Delaware.

The American Bankers Association (ABA) is a trade association composed of more than 13,100 banks, over 90 percent of the nation's full service banks. Approximately 4,000 of these banks serve their customers as trustees and executors and a number of the trusts they manage are classified as private foundations. We appreciate the opportunity to present our views on the requirements imposed by current law on private foundations.

INTRODUCTION

The Tax Reform Act of 1969 first established the "Private Foundation" as a specialized charitable entity for federal income tax purposes. In general, the 1969 Act classified all charitable trusts as private foundations unless the trustee could satisfy the Internal Revenue Service that it could avoid such a classification by meeting certain tests. Most charitable trusts established under a deceased person's will did and still do fall within this classification, even when the trustee is required to pay all the income to specified public charities and has no discretion whatsoever in the distribution of charitable funds.

As a "Private Foundation" a charitable trust falls within a system of governmental regulation, established by the 1969 Act, which was intended to assure contributions for which a charitable deduction was granted would be used for public and not private purposes. This system consists of a series of excise taxes imposed on certain "Prohibited Transactions", and very stringent annual reporting requirements designed to monitor the trustee's activities, detect any prohibited transactions, and impose an excise tax in the event any prohibited transaction occurs.

In thirteen years since the 1969 Act, it has become clear to us that this method of governmental regulation—the imposition of excise taxes on prohibited acts coupled with a stringent and detailed reporting system—imposes an unnecessary and extremely costly burden on private philanthropy. In our view, if the abuses Congress perceived in 1969 existed at all, they existed in such a small number of cases to make the reporting requirements themselves a wholly unwarranted imposition on the vast majority of charitable organizations.

We do not suggest that an excise tax on "Self-dealing", or on "Jeopardy Investments" or "Excess Business Holdings" is burdensome. Quite to the contrary. No responsible trustee would knowingly engage in such activities and the use of excise taxes is certainly an appropriate device to assure a trustee's attention. Indeed it is a better device than the "all or nothing" approach of the pre-1969 law, which would have required loss of exempt status in some such cases. However, the annual return designed to collect these taxes (Form 990-PF) is so complex and detailed that it is contrary to our entire self-assessing system of taxation.

Unlike an ordinary Fiduciary Income Tax Return (Form 1041), Form 990-PF requires much more than just a summary of taxable income and deductible expenditures. It also requires: a computation of net investment income and calculation of the excise tax owed thereon; a determination of which expenditure (or what portion of an expenditure) may be deductible for computation of net investment income vis-a-vis being deemed a disbursement for charitable purposes; a complete balance sheet, together with a list of all assets and a calculation of the foundation's net worth; names and addresses of all officers, directors, trustees and foundation managers and their compensation; names and addresses of five highest-paid employees and persons rendering professional services, and their respective compensation; calculation of adjusted capital gains and losses due to December 31, 1969 values; calculation of the foundation's minimum investment return; computation of the annual distributable amount computation of qualifying distributions and undistributed income; retention of the amount of distribution carryovers; and the answering of a whole series of questions relating to the foundation's activities.

The purpose of our testimony is to draw Congress' attention to the substantial burden that this regulatory system places on trustees of charitable trusts and the effect of this system on the creation of new charitable trusts; and to suggest ways to ease these reporting requirements without emasculating the regulatory framework of the 1969 Act.

HIGH COST OF COMPLIANCE

In our experience, it takes between five and seven hours for an experienced professional—a tax lawyer or a CPA—to prepare a Form 990-PF, regardless of the size of the trust. We cannot speculate on how a layperson—an individual not experienced with trusts, or even a small community trust department—might cope with the return.

In addition, the information required to prepare a Form 990-PF is often unreasonably difficult to obtain, particularly when considered in light of the use to which that information can be put.

The return requires monthly valuations of the fund assets, valued at high/low or mean. No automated pricing system values stocks and bonds this way. To comply, even large corporate fiduciaries must prepare these valuations by hand.

If the trust makes grants, it must obtain certification that a grantee is a public charity or it must be able to demonstrate that it took precautions to assure that the grant was expended for the intended purposes.

In some cases the trustee must make an independent determination that the recipient of the funds—even if a public charity—does not have discriminatory employment practices or (in the case of a school) admission policies.

Each charitable trust must advertise in a public newspaper once a year, advising the public that its books are open for public inspection—even if the trustee has no discretion to vary the distributions of income.

COSTS OF COMPLIANCE DO NOT VARY WITH TRUST SIZE

Every Private Foundation must file a Form 990-PF each year. Thus any charitable trust, no matter how small, must go through the exercise of preparing monthly valuations, giving public notice, obtaining all other information and then preparing the return. Based on our experience, the minimum cost of obtaining such data and filing the return can be calculated as follows:

Preparation of Federal Form 990-PF: 5 hours of professional time at $100 per hour	$500
Publication	50
Preparation of monthly valuations: 6 hours (½ hour per month) of professional time at $100 per hour	600
Total	1,150

We note here that this does not reflect any compensation for the trustee. Indeed, community trust departments or individual trustees who do not have the "in house" expertise to prepare returns such as this will typically hire a local CPA or attorney to prepare valuations and the Form 990-PF. In such cases, a trustee who does not receive at least that much as a fee each year will not only be administering the trust for free, but will actually be subsidizing its operations out of its or his own pocket.

MINIMUM SIZE CHARITABLE TRUST

Many states regulate a trustee's commissions. Even where commissions are unregulated, courts will limit a trustee to a reasonable fee. In a private trust, it is our experience that annual administration expenses (primarily professional fees and the trustee's fee) rarely exceed 10 percent of trust income and are usually less. Where charitable trusts are concerned, state courts are often protective, limiting administration costs even more (for example, by prohibiting any fees from principal). Working backwards from its fixed costs of $1,150, therefore, a charitable trust would have to earn at least $11,500 in income a year for its administration fees to be 10 percent of income, if the trustee were willing to work without commissions—$23,000, if the trustee was to be paid a commission of 5 percent of income for running the trust.

If a reasonable yield for a diversified portfolio of stocks and bonds, excluding capital gains income, is about 6.5 percent, the foregoing computations lead to the following conclusions about the relationship between the size of a very simple[1] charitable trust and its practicality:

Over $400,000—The trust can afford to pay its own costs.

Between $200,000 and $400,000—The trust can afford to pay the costs to prepare its 990-PF, but the trustee must work for a reduced fee.

Less than $200,000—The trustee must pay part of the costs to prepare the 990-PF and work for no fee.

HIGH COSTS OF ADMINISTRATION HAVE DISCOURAGED CREATION OF CHARITABLE TRUSTS

The substantial costs required to administer a charitable trust are familiar to accountants, attorneys, trust officers and other professionals in the estate planning field. They will usually explain these costs to someone who is considering creating a charitable trust in his will. Once the client understands these facts, he or she will often decide either to leave the funds directly to charity or, frequently, to make a non-charitable gift.

For this reason, our member banks have seen a marked decrease in the creation of charitable trusts since the 1969 Act. One typical large trust institution, for example, administers 29 private foundations, of which only one was established after the 1969 Act.

CHARITABLE TRUSTS SHOULD NOT BE DISCOURAGED

In our experience, funds which are no longer left to charitable trusts are either passing to large public charities or for private purposes to non-exempt individuals. While this may have been intended by Congress, it is submitted that charitable trusts should be encouraged, not discouraged:

Large public charities must serve a wide variety of needs, often in a large geographic area, and cannot be administered with as much sensitivity to local needs;

Small charitable trusts can be tailored to fulfill specific needs, fostering a kaleidoscope of charitable activities to provide multifaceted cultural enrichment;

Small charitable trusts can accommodate investment philosophies which differ from large institutional endowment funds.

SUGGESTED CHANGES

We assume that Congress wishes to regulate private charitable trusts to prevent "prohibited transactions" and to assure distributions are made for charitable purposes. We assume that Congress does not wish to regulate charity anymore than is necessary to meet the goal. We suggest a two-pronged approach to easing the administrative burdens on private foundations which distinguishes between cases where there is a very low risk that any prohibited transactions will occur and cases where the risk is higher. First, in low risk cases we would substitute for the Form 990-PF a Form 1041 accompanied by the trustee's certification that it has not engaged in any prohibited transactions as defined in Sections 4941 through 4945 of the Code, and has distributed sufficient income to comply with Section 4942. We would also eliminate the 2 percent excise tax for these trusts. Second, in the higher risk cases, we would clean-up and simplify the 990-PF to make it easier to prepare and file.

I. Certain charitable trusts should file 1041's

The types of charitable trusts which we feel fall within "low risk" category include:

Trusts with annual receipts of less than $25,000;

Trusts which have not received contributions within the last five years;

Trusts which would qualify for 509(a)(3) Supporting Organization status but for the fact that the trust cannot satisfy the "integral part" test.

Trusts with less than $25,000 annual receipts

Code Section 6033(a)(2)(B) gives the Commissioner discretion to relieve any organization from filing an information return if he determines it is not necessary for the efficient administration of the internal revenue laws. Since 1969, the Commissioner has twice raised the minimum level for filing for non-private foundations whose gross receipts each year are normally not more than a certain level. In 1977, the minmum was raised from $5,000 to $10,000 and then to $25,000 in 1982.

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[1] If the trust makes grants or is an operating foundation, its costs increase enormously.

We feel that the size of a private foundation—particularly a charitable trust—should also affect its filing requirements. If the Commissioner has decided it makes no sense for non-private foundations with less than $25,000 of annual receipts to file any annual return, it would seem to follow that he could determine that private foundations with receipts under that amount could qualify for simplified reporting. Indeed, we submit that the need for close scrutiny decreases in direct proportion to foundation size.

Smaller charitable trusts could be permitted to file Form 1041 and certify that all income has been distributed and that it has incurred none of the excise taxes on prohibited transactions. If the IRS needs to know the investments held in the trust, a simple statement of assets could be added at far less cost and difficulty than the current detailed and complex balance sheet.

Trusts with no additional contributions

Many private foundations receive no additional contributions after initial funding. This is especially true for charitable trusts which generally never receive or solicit additional contributions. While there may be a need to monitor the activities of charitable organizations, the reporting requirements should be eased for those organizations which have not received any gift or donation within the last five years. In such cases the risk that charitable funds will be used for non-charitable purposes is less than where contributions are received regularly. We would suggest that all such charitable trusts likewise be permitted to adopt the simplified form of reporting suggested for smaller trusts. This would certainly ease the adminstrative burdens of many charitable organizations and yet maintain a reasonable reporting system consistent with legitimate public concern.

Quasi supporting organizations

We would also suggest a private foundation which almost qualifies as a 509(a)(3) Supporting Organization except that it cannot satisfy the "integral part" test set forth in Treas. Reg. Section 1.569(a)-4(i)(3) should qualify for this simplified reporting system. This change may be able to be effected without amending the Code.

The statutory requirements for qualification as a supporting organization are relatively simple and straightforward. The supporting organization must: 1) be organized and operated exclusively "for the benefit of" one or more public charities; 2) be "operated, supervised, and controlled by or in connection with" one or more public charities; and 3) not be controlled by one or more disqualified persons.

The regulatory requirements are, however, much more specific and complex. Treas. Reg. Section 1.509(a)-4(a)(2) through (4) set forth the various tests under Code Section 509(a)(3) which must be met to avoid private foundation status, to wit: the organizational test, the operational test, the relationship test, and the control test. While the organizational, operational, and control tests are direct and relatively easy to satisfy, the relationship test is both cumbersome and unduly complex.

Basically, the relationship test is designed to insure that the publicly supported organization will have sufficient interest in, or control over, the supporting organization to prevent any abuse or violation of its exempt purposes.

To satisfy the relationship test, the supporting organization must be: (1) operated, supervised, or controlled by, (2) supervised or controlled in connection with, or (3) operated "in connection with" one or more publicly supported organizations. Although the first two relationships are relatively easy to establish, they may be utilized only if control is transferred to the public charity. While the third relationship is the most difficult to satisfy, it is the most useful for those wishing to create an organization independent of the public charity.

To qualify as an organization operating "in connection with" a public charity, two additional tests must be met: the responsiveness test and the integral part test. Of the two, the integral part test is the more demanding. Unless it can be shown that, were it not for the supporting organization, the supporting organization's activities would normally be conducted by the public charity itself (which is extremely difficult), the supporting organization must show that the amount of income it furnishes is sufficient to insure the charity's attention to its operations.

This "attentiveness" requirement has often forced an arbitrary earmarking of funds for a particular project or program to insure such attentiveness. These funds can often be used more effectively elsewhere, but projects are created to avoid the burdens of private foundation status. Moreover, many charities are reluctant to earmark ad infinitum. While a charity may be willing to commit the use of funds for two or three years, few can see any advantage to, and in fact object to, committing in perpetuity. Due to the rapidly changing economic conditions experienced recently, most public charities prefer the flexibility of being able to use funds where they will do the most good.

II. Simplify Form 990-PF

If the foregoing suggestions were adopted, many charitable trusts would no longer be required to file Form 990-PF; they would file a Form 1041 with special declarations instead. The foundations and trusts which would continue to file Form 990-PF would typically be: (i) operating foundations; (ii) grant-making institutions; and (iii) certain charitable trusts.

We would change Form 990-PF to ease the administrative burden on these charities in the following manner.

Eliminate public notice where income distributions are fixed by the governing instruments;

Eliminate the computation of adjusted net income;

Replace the "Balance Sheet" with a schedule of Assets and Liabilities;

Reduce valuations from monthly to quarterly or even annually in small trusts;

Change the prescribed valuation method from high/low mean to any reasonable method consistently chosen by the trustee;

Raise the minimum for expenditure responsibility from $1,000 to $2,500;

Permit the Commissioner to waive penalty excise taxes when the error is due to reasonable cause and not negligence or willful neglect.

Public Notice

The requirement that a notice be published should be eliminated for those trusts whose governing instrument specifies the beneficiary organization or organizations. In these cases, what purpose is served by the notice? Grant seekers not named in the instrument would gain nothing. Of course the beneficiary organizations are entitled to notice and we believe a direct notification is most efficient. Proof that notice has been given could be verified by the Service as a part of the qualification procedure. A simple letter of acknowledgement from the supported organization should suffice.

Computation of Adjusted Net Income

On Form 990-PF, column C of page 1, the computation of adjusted net income should be eliminated. There is no longer any need for this computation since the 1982 change in the statute requires minimum distributions to be 5 percent of net assets.

Balance Sheet

The balance sheet requirements from the Form 990-PF should be eliminated. The present balance sheet is really a detailed statement of cash flow. It requires a detailed comparison of assets at the beginning of the year with the assets at year end, all adjustments including changes in cost basis, receipts and disbursements. It must be prepared on an accrual basis, as a result it must be prepared manually.

A list of assets, showing the holdings at cost and market can be prepared simply and inexpensively by computer. Further, banks routinely provide regular cash statements detailing all cash transactions in the fund.

Valuations

We would reduce the number of valuations required, and permit use of commercial valuation systems in common use. No commercially available source provides a high/low or mean valuation similar to that presently required.

Currently, monthly valuations are required. Significant cost savings would result from quarterly valuations for larger and annual valuations for smaller private foundations. It is true that these valuations provide the basis for computing minimum distribution amounts and a once a year date might fall when the market is at an extremely high (or low) point. To avoid aberrations which may result, the minimum distribution might be computed on the average of the beginning and end of the year valuations.

Expenditure Responsibility

Raise the expenditure responsibility reporting requirement from $1,000 to $2,500. IRC Section 6033(c) was added by P.L. 96-603 (12/28/80). In general, it provides that information returns need not contain the name and address of an indigent or needy recipient of a gift or grant from a foundation provided the total received by the person does not exceed $1,000 during the year. This section was added to simplify reporting requirements and reduce administrative costs.

Attempts have already been made to convince the Commissioner to increase this amount by exercising his discretion under Section 6033(a)(2)(B) as has been done on two occasions for non-private foundations. According to GCM 38835 (1/19/82), the Special Assistant for Exempt Organization Matters believed that persuasive arguments had been made to increase the reportable amount to $2,500 as " 'the expenses of medical, social services, and other emergency services have escalated to such a degree.' "

The memorandum concluded, however, that the Commissioner's statutory discretion did not extend to Section 6033(c). Hence any increase in the reportable amount must come via legislation.

Discretion to Waive Penalties

Sections 4940 through 4944 contain the excise taxes on prohibited transactions. These establish extremely onerous penalties--100 percent of fund assets in some cases—without any provision for discretionary forgiveness. We recommend these sections be amended to permit the Commissioner to excuse such penalty taxes provided failure to comply is due to reasonable cause and not willful neglect. Such a standard would be similar to those which impose penalties for failure to file various income tax returns and/or pay the appropriate tax.

CONCLUSION

The reporting requirements enacted in 1969 for private foundations represent, in our opinion, an undue burden on private philanthropy. Form 990-PF, by its complexity, establishes a high annual fixed cost for any charitable trust, no matter how simple its terms or small its corpus. The high annual cost of administering private charitable trusts causes many would-be donors, who cannot afford to create a $200,000 to $400,000 trust, to choose between direct gifts to large public charities or gifts to non-exempt trusts or individuals. Private philanthropy through the use of small, sensibly administered charitable trusts has many advantages over large institutional endowments and should be encouraged, not discouraged.

We would encourage Congress, therefore, to take every appropriate step to ease the administrative burdens imposed on charity by the 1969 Act.

Chairman RANGEL. Mr. Stark.

Mr. STARK. Mr. Ture, do you feel there should be no minimum distribution requirements on foundations?

Mr. TURE. Right.

Mr. STARK. Your reasoning is that today's distribution reduces tomorrow's capacity to distribute.

Now, if that is the case—let me ask it this way. Do you think, for example, a foundation should be allowed to organize and then not make any distribution for, say, 10 years?

Mr. TURE. Mr. Stark, I certainly would not rule out that possibility.

Mr. STARK. You think that is proper?

Mr. TURE. I don't see anything improper about it. There isn't anything about that situation that necessarily says that the creation——

Mr. STARK. How about 20 years?

Mr. TURE. I think you can carry the question to the extreme, and I would have to agree, sir, that there is really very little coming out.

Mr. STARK. You understand investments—and let's just take a million-dollar foundation. You understand that about half a million of that is the public's money; is that not correct?

Mr. TURE. That is one way——

Mr. STARK. It is a tax forgiven, is it not?

Mr. TURE. I know what that says, though, Mr. Stark. It says the money produced by the donor through his own activities in fact belongs to the Government. In fact——

Mr. STARK. No, it merely says what the law is. There is a law—without getting to the philosophy of whether it is a correct law or not—the law says that about half of that money ought to be paid to the Treasury and we forgive approximately half because it is a charitable purpose. That is a fair approximation of the law, isn't it?

Mr. TURE. I would not articulate it in the same way you have.

Mr. STARK. But empirically it is——

Mr. TURE. The arithmetic comes out the same way.

Mr. STARK. Arthmetically, assuming that 50 percent of it is tax forgiven, regardless of the merits of the tax, it seems to me if we allow that to go without any distribution for 20 years, that we are getting an unconscionably low rate of return on our investment. As a good businessman, I would think that you and I might pick a minimum rate that we would be willing to stake our professional reputation on as, what, the T bill rate, that ought to be expected of any prudent man over time?

Mr. TURE. Depends on what "over time" means.

Mr. STARK. Would you hire an investment manager that couldn't match the T-bill rate over 20 years?

Mr. TURE. If the T-bill rate actually reflected current cash flow, I would disregard that entirely.

Suppose that investment were——

Mr. STARK. A sum that you and I could find a rate so low as to shock us in terms of investment. You are saying no investment manager—what if you lose money?

Mr. TURE. Suppose the current cash flow is zero. Suppose it remains zero for a few years.

Mr. STARK. I am suggesting to you the ridiculousness of your circuitous reasoning. By discounting cash flow, you are willing to not require any return.

It would seem to me that that position is at the extreme end of reason and ought to be disregarded. It seems to me that people could, and indeed in the past have, frustrated the intent of giving any money to charity and have done nothing more than retain control of corporations.

Do you feel that that would be a reasonable reason for maintaining a charitable trust, just to control a private business?

Mr. TURE. Let me, if I may, have the liberty of formulating a response to the main thrust of your question, which is, is there some appropriate minimum rules with respect to the distribution of foundation assets?

Let me cite as a counter kind of example an investment portfolio of a foundation which is very largely in properties that will appreciate or are anticipated to appreciate in value over an extended period of time, even though their current cash flow is very, very low indeed. As we well know, I am sure you are as aware, if indeed not more than I, that is not unusual to find in the business community.

To say that a foundation should be in fact one way or another prohibited from investing in that kind of asset seems to me serves no useful public purpose, particularly in view of the fact that its objectives with respect to supporting charities may call for a substantial growth in those outlays in the future, substantial compared to its present outlay requirements.

I think those are the considerations which are simply ignored by any minimum distribution rule. I therefore would urge, one, repeal of the rule; and failing that, at least its application with respect to the earnings of a foundation over a much longer period of time than a single year.

Mr. STARK. You also state in your testimony that the variety of activity of foundations is enormous, ranging from providing food, shelter, and other support for human derelicts to undertaking the most basic and abstract research in virtually all fields of knowledge.

Do you know of any foundations that make contributions to human derelicts?

Mr. TURE. I believe there are any number of foundations whose distributions go to organizations which indeed provide such support.

Mr. STARK. What kind?

Mr. TURE. Donations made to the church organizations, which provide shelter, food and so forth, to so-called street people.

Mr. STARK. To derelicts?

Mr. TURE. Yes.

[The following was subsequently received:]

Mr. Ture wishes to provide for the record the relevant definition of "derelict," viz., a person abandoned by society. cf. The Random House College Dictionary, revised edition, 1980, p. 358.

Mr. STARK. OK. I would be interested in any foundations or any institutions that identify their work as specifically with derelicts.

Mr. TURE. There is no pejorative meaning to the word.

Mr. STARK. I would love to see their prospectus. I think perhaps, Mr. Ture, the word "derelict" is one that has about as much use in our lexicon as the idea of not paying out any money from the foundations to charities.

I have no further questions.

Chairman RANGEL. Mr. Ture, I assume that you believe Congress has the responsibility to see that these foundations are operated for the public benefit. You don't have a problem with that?

Mr. TURE. No, indeed.

Chairman RANGEL. Without providing some type of minimum payout, how would the Congress have any idea as to whether there was any public benefit from the XYZ foundation?

Mr. TURE. I think that indeed the objectives to be served—in expression of their concern, do not require the minimum distribution rules now in the section.

Chairman RANGEL. You made that abundantly clear. I am asking you how can we, as the members of the tax-writing committee, determine whether the XYZ foundation, which is not paying out for two decades now, has any public benefit whatever?

Mr. TURE. If in fact you find a substantial number of foundations for whom the payout rates are virtually zero or very low indeed over very extended periods of time, I would think that indeed there would be the basis for considerable concern by the Congress and reevaulation of the rules.

I don't know that that is indeed true and it seems to me the evidence suggests the contrary.

Chairman RANGEL. So you are saying that if a hypothetical foundation enjoyed tax benefits for 20 years and had served no worthwhile purpose, then the tax-writing committee should correct it after it has been so determined?

Mr. TURE. Let me offer the following general observation, Mr. Chairman.

In this area, as in many others, it seems to me the legislation has been focused on very small numbers of exceptional kinds of abuses rather than on prevalent or majority practice. The correction of those abuses that are undertaken by a, relatively speaking, handful of institutes is at the expense of the overwhelming majority.

Chairman RANGEL. Mr. Ture, I am not arguing with what you are saying. I am just asking you to assist us. You have not responded. I am saying that assuming what you say is true, you have agreed that if we disregard these minimum payouts, that even though there may be a few abuses we should wait until after the fact and then correct it. I am asking you as a tax expert. You would have to be the first to admit that there are at least some misconceptions about the role of foundations. You have said that throughout your testimony. Here we want to correct any such misconceptions.

If there are misconceptions that foundations are created for the benefit of the donors and not for the public, and if in response to Mr. Stark you are saying that Congress should not mandate minimum payout and that it could be 20 years before there is a charitable distribution—I assume you are just responding to the hypothetical question—then this does not improve the image of foundations.

You would not agree that perhaps the tax benefits should occur when the charitable occasion occurs. You would not support that, would you?

Mr. TURE. No, that is unduly restrictive.

Chairman RANGEL. So the benefit is up front. We want to have some way of knowing that this is not just a private transaction between a wealthy family and a foundation.

You are going to have to either help us or accept our mistakes.

Mr. TURE. I think your challenge is certainly wholesome.

Let me try to respond, and if I may have the opportunity to submit one of the IRET studies on this matter as it is produced.

Responding now, if indeed the Congress does determine that there is benefit to the donors without benefit to the philanthropy, to charities, and that that is extensive rather than an exceptional kind of incident, then indeed I think that I would reexamine the propositions I have submitted to you.

In any event, it seems to me if abolition of 4942 is viewed as too draconian, that at the very least it ought to be modified to allow the application of the rule on a declining penalty basis over a much more extended period of time than the single year.

Chairman **Rangel**. Often when you talk about abuse, I assume you are saying the foundation is set up without any intention of helping the charitable organizations.

Mr. **Ture**. There may be indeed such, but I don't know of any.

Chairman **Rangel**. I am saying that if indeed the foundation is set up for a charitable purpose, that we should not have to wait until it is obvious that there is no contribution to charitable organizations and then say it is an abuse.

Mr. **Ture**. On the contrary, I would say you ought not to penalize the foundation until establishment of abuse is clear.

Chairman **Rangel**. So you don't consider not making charitable contributions an abuse?

Mr. **Ture**. Contemporaneously, certainly not.

Chairman **Rangel**. You have no idea what is temporary. Temporary could be 20 years?

Mr. **Ture**. I said contemporaneous, but, yes, it could be 20 years.

Chairman **Rangel**. Do you believe that the foundations are as public as they should be? In other words, there is a common conception of foundations, at least from the testimony we received yesterday, that it is a very private type affair between the donor and his lawyer and the board of directors, which could be the board of directors of the business as well.

Do you think the public might have a better understanding as to what foundations intend to do if annual reports were required? I am not talking about the paperwork Mr. Hayes referred to. I am talking about public accounting, oversight by the public, the same as we have with public charities.

Mr. **Ture**. I am not sure what you mean. The public reports or public oversight of the foundations or the charities—which?

Chairman **Rangel**. I am just saying, revealing who is on the board, who they are, what the assets are, making it public, what they hope to give, what has been given. Just saying who the foundations are.

One person testified they couldn't even find them in the phone book, most of the foundation people.

Mr. **Ture**. Without addressing that question, it seems to me that that is a perception of the private foundation as a public entity. If it is a public entity, then I don't see any basis for the private foundation rules or private foundation as an entity covered by tax law.

Private foundations exist because there is a demand in the economy for the kinds of services they perform. Those are not by definition public services.

Chairman **Rangel**. Let's try it again because I am certain you misunderstood my question.

These private purposes that the foundations have been formed for are not so private that you are suggesting the public should not know what they are?

Mr. **Ture**. I am not suggesting that they ought to be hidden nor do I suggest there ought to be a requirement imposed for public accountability.

Chairman **Rangel**. Why for heaven's sake, not?

Mr. **Ture**. I don't see what the purpose of it is, sir.

Chairman **Rangel**. The purpose would be to find out why they are not required to pay taxes on their holdings, and why these charitable contributions through the foundations are well intended, and because they have nothing to hide. We are talking about an annual report as to what they are doing.

Now, I agree with you, profits belong to whomever makes them and it is up to them to influence the lawmakers as to whether they should or should not pay taxes. The way things are looking very few corporate people would have to pay taxes in the future; but even so, some of them do try to relieve themselves of this liability—that is public policy. You cannot deny that, Mr. Ture. That is public policy as to who pays taxes and who doesn't, good or bad, it is public policy.

Mr. TURE. That is unarguable.

Chairman RANGEL. So when you say, I would rather not pay taxes because I would like to provide a public service, you don't have any problem with that.

Mr. TURE. Right.

Chairman RANGEL. Right?

Mr. TURE. Sure.

Chairman RANGEL. So annually you tell what you are doing in connection with your public service.

Mr. TURE. Mr. Chairman, do you want this information posted in the daily newspapers?

Chairman RANGEL. Well, Mr. Ture, I really would believe that most of the foundations—at least those who have talked with me—are so proud of what they are doing that they would just publish papers as to what they are doing.

Mr. TURE. Certainly they have that privilege.

Chairman RANGEL. They are proud of who sits on their board and the great work they are doing and they identify those that have been the beneficiaries of their largest grants. So I am just talking about something similar to what the foundations who are proud of their work would be doing.

I had hoped that you would be joining with me to make certain that all people who create foundations would be just as proud. But if you would like to leave this hearing believing that they should receive the benefits of more favorable tax treatment but they should not share that with the taxpayers, I don't have any problem at all with your statement.

Mr. TURE. Well, I have not made that assertion, sir, I certainly would not——

Chairman RANGEL. I say share it, I mean share it publicly. I think you have more expertise in this matter than I do, so when you asked me should they put it in the New York Times, frankly I don't care where they put it. But I would ask you if you were representing the foundations, and if you agreed that they are proud of the work they are doing, you know, how would you best satisfy the suspicion that a small segment of the population has, the taxpaying population, of what foundations are doing?

I just ask that not to influence your answer.

Mr. TURE. They are required indeed to justify, to validate their tax-exempt status and to do so periodically. But beyond that I do not think it is good public policy to impose additional costs on the foundation unless there can be identified some explicit purpose that is served by, say, public announcements of this sort, if public announcements are differentiated from the reports that are required to be filed with the IRS.

Chairman **Rangel**. Not IRS, they are looking to put people in jail. I am talking about letting the public know what you are doing. There is a difference, Mr. Ture, in what we are talking about; but again I respect your experience in this, you know exactly what that difference is, and your contribution to this hearing is quite different from—it is a different view and it is well respected.

I want to thank the entire panel.

Mr. **Stein**. May I make one comment from the other end of the spectrum to this whole discussion—both historically and factually. First from the historical point of view, I think that the experience 14 years ago amply supports what you and the other members of the committee have said. The prior provision in the Internal Revenue Code dealt with unreasonable accumulations by foundations and was found to be unadministrable, incapable of enforcing the injection of assets into the charitable stream and totally unworkable. The whole purpose of the new provision as it developed in 1969 and thereafter was to insure exactly what your committee and the Finance Committee was attempting to do at that time.

More importantly on the factual end, I represent hundreds of foundations and charitable trusts. I want to stress that in every case they all have their own charitable programs and commitments of a philanthropic nature that go well beyond any minimum distribution requirements. It has not made one iota of difference in the past 14 years whether those requirements involved a 6- or 7-percent distribution or the current 5 percent. They have their own grantees that are depending on them for funds, they have their own programs and they are in every case distributing well in excess of the minimum requirements.

I would like to add a footnote: That is not to say we shouldn't have the minimum requirements to assure that all foundations and charities continue to use their funds for charitable purposes.

Chairman **Rangel**. I really appreciate that, Mr. Stein, because we are here to make contributions easier and to make certain that sooner or later it gets to some charitable cause other than the donor's.

Would anyone else like to respond?

If not, Mr. Thomas?

Mr. **Thomas**. Briefly, I was upstairs at another committee meeting. I apologize.

I understand you are opposed to the 5-percent payout, Mr. Ture, and you would prefer doing away with it.

Mr. **Ture**. Yes.

Mr. **Thomas**. Are you interested in looking at an interim position such as a cumulative 5-percent average over a period of years, 5, 10, 15 years, which would allow some planning? You mentioned real estate holdings which would not produce it right away but would over a time frame.

Mr. **Ture**. That is a very good alternative to the proposal which I suggested. That is in lieu—if repeal is deemed to be too Draconian a solution, that in lieu thereof the minimum distribution rule should apply with respect to distributions over a considerably longer period of time, perhaps 10 or 20 years.

Mr. **Thomas**. With penalties when you begin to reach a point in the latter part of the years that you clearly cannot meet the cumulative total, the 20 or 25 percent over the years?

Mr. **Ture**. I would take a slightly different approach though it doesn't rule out what you suggest, the approach would be the more rapid the rate of increase in the foundations' distributions the lower should be the minimum distribution rule.

Mr. **Thomas**. Thank you.

Mr. **Stark** [presiding]. Mr. Duncan.

Mr. **Duncan**. I have no questions, Mr. Chairman.

Mr. **Stark**. I want to thank the panel for their contribution.

[The following was subsequently received:]

ROBERTS & HOLLAND,
ATTORNEYS AT LAW,
New York, N.Y., July 14, 1983.

Hon. CHARLES B. RANGEL,
Chairman, Subcommittee on Oversight,
Committee on Ways and Means,
Washington, D.C.

DEAR MR. CHAIRMAN: Thank you for your letter of July 7 (copy enclosed).

In order to amplify my testimony in support of the 5 percent distribution requirement imposed on private foundations, I would like to refer you to page 25 of the 1969 Report of the Committee on Ways and Means, H.R. No. 91-413, 91st Cong., 1st Sess., Pt. 1 (Aug. 2, 1969), as follows:

Present law.—Present law (sec. 504(a)(1) of the code) provides that a private foundation loses its exemption if its aggregate accumulated income is "unreasonable in amount or duration in order to carry out the charitable, educational, or other purpose or function constituting the basis for exemption under section 501(a) of an organization described in section 501(c)(3)."

General reasons for change.—Under present law, if a private foundation invests in assets that produce no current income, then it need make no distributions for charitable purposes. As a result, while the donor may receive substantial tax benefits from his contribution currently, charity may receive absolutely no current benefit. In other cases even though income is produced by the assets contributed to charitable organizations, distributions may not be required. In such circumstances, no current distribution is required until the accumulations become "unreasonable." Although a number of court cases have begun to set guidelines as to the circumstances under which an accumulation becomes unreasonable, in many cases the determination is essentially subjective. Moreover, as is the case with self-dealing, it frequently happens that the only available sanction (loss of exempt status) either is largely ineffective or else is unduly harsh.

Your committee has concluded that substantial improvement in the present situation can be achieved by providing sanctions if income is not distributed currently. A graduation of sanctions, designed to produce current benefits to charity, is provided.

Thank you again for the opportunity to testify before the Subcommittee on Oversight of the Committee on Ways and Means. If I can be helpful in any other way by furnishing information to you or your staff, I would be most pleased to do so.

Sincerely,

MALCOLM L. STEIN.

Enclosure.

COMMITTEE ON WAYS AND MEANS,
Washington, D.C., July 7, 1983.

Hon. MALCOLM STEIN, Jr., Esq.,
Roberts & Holland,
30 Rockefeller Plaza,
New York, N.Y.

DEAR MR. STEIN: On behalf of the Members of the Oversight Subcommittee, I would like to take this opportunity to thank you for your valuable contribution to the Subcommittee's recent hearings on private foundations. Your testimony was both thoughtful and thought-provoking, and we would welcome any additional recommendations and comments you may have. Your participation helps to assure that the record of these important hearings will be balanced and comprehensive.

When the hearing record is printed, I will send you a copy, along with any formal report or recommendations issued by the Subcommittee. Thank you again for taking the time to prepare an excellent statement and for appearing before the Subcommittee. Your efforts were very much appreciated and you have made an important contribution to the legislative process.

Sincerely yours,

CHARLES B. RANGEL,
Chairman.

Mr. **STARK**. The next panel consists of foundation managers: David Rogers, M.D., president of the Robert Wood Johnson Foundation; Roger Heyns, president of the William and Flora Hewlett Foundation; William Bondurant, executive director of the Mary Reynolds Babcock Foundation, Inc.; James Shannon, executive director of General Mills Foundation; and Marjorie Powell Allen, president of the Powell Family Foundation.

I would repeat the chairman's admonition that we limit the presentations to 5 minutes. Your prepared testimony will appear in the record and we would ask you to summarize your testimony. Your comments or paraphrasing of your testimony is welcome.

You may comment on previous testimony or add additional remarks as you see fit. I would call on you in order.

Dr. Rogers, please, would you proceed.

STATEMENT OF DAVID E. ROGERS, M.D., PRESIDENT, THE ROBERT WOOD JOHNSON FOUNDATION

Dr. **ROGERS**. Thank you, Mr. Stark.

As you have indicated, I am president of the Robert Wood Johnson Foundation. I am a physician by background. The foundation is a large one, it devotes most of its energies to improving the health and health care for Americans having a tough time getting it.

I also serve as the elected chairman of the board of the Council on Foundations. You heard the fine testimony of our president, Jim Joseph, yesterday. My assignment is quite narrow. It is to acquaint the committee with what private foundations have done in the field of health and medical care. I can keep my remarks very short. You do have my submitted testimony. I hope it will be looked at. I think it tells an impressive story of foundation contributions.

Let me make just four points using the health area to address several questions which this subcommittee put to members who were seated here yesterday.

First, during the period since the 1969 Tax Act this country has made gains in bringing medical care to all Americans, and simultaneously in that period we have seen greater improvement in health statistics than ever before during this century. The point I wish to make is that foundations have played a vital role in that progress. They are continuing to work in that area.

Second, I want to sock home the point that foundations are but a bit player in the health care area.

Third and paradoxically, despite the minuscule nature of their cash contributions to national health expenditures they have had a disproportionate clout because of the special nature of their investments in long-range future oriented programs designed to get at root causes of poor health and in that way they are quite different from and act differently from that that we ask of our Government.

And my last point, that foundations are a moderately endangered species. If this subcommittee is persuaded as I sense that a number of you were yesterday, that foundations are quite precious and uniquely American institutions, and that they are worth preserving, I hope you will act to remove some of the impediments which modestly hamper their maximum effects.

Let me expand slightly on those points. I hope you read the remarkable progress data we have made in the last 15 years in bringing medical and health care services to Americans, particularly those that are black, particularly those that are poor, those that are separated by geography or culture from mainstream America.

Second, and concomitantly with that, the fact that during that period we have also made dramatic improvements in health. Our overall death rates have dropped more swiftly since 1969 than at any time in the century, we have had a dramatic drop in infant death rates, particularly for black infants; those rates are still too high. We have done much better in bringing health care to our elderly.

I think the facts will show that foundations have played a significant role in keeping those medical problems on the national agenda and that they have initiated many trailblazing efforts to improve care and knowledge and that those have gradually gotten assimilated into the mainstream of American life.

I think you should know, also, that the current economic climate and some of the cutbacks threaten to put some of those gains at hazard.

My second point I can assure you that foundations will continue to work in this area and indeed are increasing their contributions to health care, but they cannot fill the gap. Foundations spent $1 in $5 for medical care in 1982, that being $655 million. That is up 20 percent in the last 5 years but, and I wish to emphasize this point, during that time health expenditures have risen by about 88 percent.

If one couples all of the foundation contributions in health from all foundations in this country they make up less than two-tenths of 1 percent of what we will spend in health each year.

Third, if that be the case, why are foundations important? Some of the reasons were alluded to yesterday. We are, I think, when at our best, the seed corn that allows germination of new ideas about how to make health better. Let me give two facts.

About 90 cents of every foundation dollar in health goes into long-range investments to deal with root causes of American ill-health and misery and putting systems and demonstrations in place so people could look at them and decide their worth.

That stands in striking contrast to what we ask of our Government where about 80 cents of every dollar goes to the here and now, it must simply go for delivering health care of today.

Second, we have the privilege of continuity. We can stick with the problem long enough to see it through. I have given a number of such examples in my testimony.

Key officials in the administration generally have a short crack at some long-term problems. For example, since I have taken on my present role there have been six Secretaries of HEW and HSS and some fine ideas often get lost in that shuffle. It takes time, takes careful study, perserverence to get at root causes and that is where foundations have a rather unique privilege.

Lastly, Mr. Chairman, I have indicated that foundations are in my judgment a moderately endangered species. Although a lot of figures were bandied about yesterday about births and deaths of foundations, in the judgment of most of us, major new foundations are being formed at significantly slower rates than in the past and I think that may need your attention.

Yesterday you asked each of your witnesses what was most troubling to foundation officials nowadays, my own answer is quite a simple one, the health field is growing rapidly, foundations are not.

Thus foundations are less and less able to fund many splendid new ideas for making health and medical care more effective, more affordable or more equitably accessible to all irrespective of race, geography or income.

Ten years ago we had 3 million people working in the health care industry, we now have about 7 million so we must say "no" to very many good ideas that deserve funding, new ideas about hospices or home health care or special programs to help minorities or the frail elderly or research on Alzheimer's disease or research on AIDS or what have you.

In response to questions yesterday, I believe what could be done in the way of minor adjustments to the 1969 Tax Act to permit us to do our own quite special job more effectively and more productively. I would point out that the Robert Wood Johnson Foundation became a national philanthropy only in 1972. Thus we are a creature of the post-1969 era. That law has not hampered us significantly. We are proud of our record.

I think the act has in general served the Nation well. But I would suggest to you that the Conable bill 3043 does make some appropriate course corrections. I hope you will recommend its passage and I thank you for listening to me.

[The prepared statement follows:]

STATEMENT OF DAVID E. ROGERS, M.D., PRESIDENT, THE ROBERT WOOD JOHNSON FOUNDATION

Mr. Chairman, my name is David E. Rogers. I am a physician and the president and a trustee of The Robert Wood Johnson Foundation in Princeton, New Jersey. I came to the Foundation from a 30-year career in academic medicine. Immediately prior to accepting my foundation post, I was vice president for medical affairs and dean of the medical faculty of The Johns Hopkins University and medical director of The Johns Hopkins Hospital.

The Robert Wood Johnson Foundation was incorporated in New Jersey in 1936, and became a national grantmaking philanthropy after receiving General Robert Wood Johnson's major bequest in December of 1971. The Foundation's grant program is highly targeted toward assisting institutions and organizations seeking to improve health care in the United States. We are the largest single private foundation source of health funding in the country. The value of our assets today is $1.4 billion, and we have made appropriations totaling $517.5 million during the past eleven and a half years.

I also serve as the elected chairman of the Board of Directors of the Council on Foundations. However, I am here today to focus on health and health care as an area of private foundation activity. Several thousand private foundations make grants directed at improving the health and health care of Americans, and the record of their achievements is impressive.

In preparing for this hearing, I felt answers to four questions might be most useful to you in assessing private grantmaking in health:

1. What have been the returns on investments in health and health care in this country?

2. In actual dollars, how much do private foundations contribute to health care on the national scene?

3. Given the amount that foundations expend in health, what roles can these institutions play that is different from those of the public sector?

4. How well are private foundations performing their roles?

Let me share with you my answers to these questions.

1. What have been the returns on investments in health and health care in this country?

Within the 15 years that are the focus of this hearing, ou nation has made extraordinary progress in improving the health and lives of its people, and it is clear that foundation funds have been important--sometimes crucial--in supporting many of those who have been at the forefront of these efforts.

Beginning in 1968, death rates began steadily decreasing at one of the fastest rates seen during this century. By 1980, the expectation of life at birth had grown by four years. Overall adjusted death rates for all Americans had dropped by 20 percent, and there were reductions in deaths from 10 of the 15 leading killers. In particular, overall infant and maternal death rates had fallen profoundly, and death rates for black newborns had dropped a dramatic 45 percent.

Especially reassuring were the decreases in deaths from diseases in which medical care can clearly be lifesaving. These included deaths from childbirth (down 72 percent between 1965 and 1980), pneumonia (down 53 percent), tuberculosis (down 52 percent), and diabetes (down 31 percent).

These improvements have encompassed all age groups. Particularly noteworthy in greying American have been impressive changes in death rates among those over 65. From 1955 to 1967, we lagged behind most other countries in the western world in our progress toward longer lives. However, in the next decade, we led most others with a marked improvement in age-adjusted death rates among the elderly. While concerns about the quality of that extension of life deserve, and are receiving careful examination, the fact remains: we've made impressive progress.

Not all of these improvements in health are due simply to more or better medical care. They do, however, coincide with the greatest public and private efforts ever made in this country to improve health care. They also coincide with the nation's most aggressive and successful effort to increase access to medical services for the poor and the elderly.

On behalf of private foundations making grants in the field of health, I want this subcommittee to know that we remain steadfast in our commitment to do our share to preserve and advance these health and health-related gains.

2. In actual dollars, how much do private foundations contribute to health care on the national scene?

One out of every five private foundation grant dollars is in support of health and health care--an amount estimated to be $655 million in 1982.* This makes health the third ranking area of activity for private foundations, just behind social welfare and education.

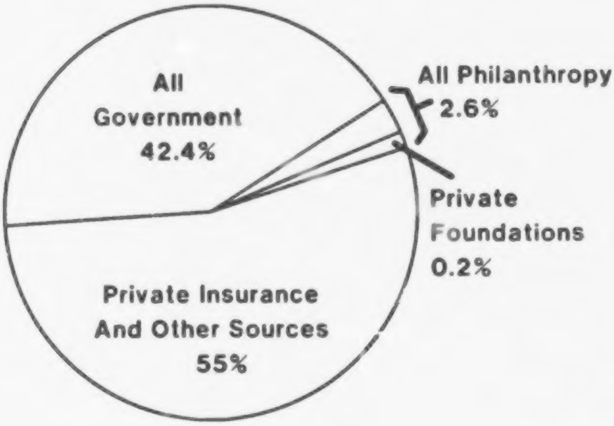
Fifty of the 22,000 private foundations expend one-third of all foundation funds devoted to improving health and health care. Actually, less than three percent of all private foundations account for approximately 60 percent of private foundation expenditures in health. Because the health and medical care sector has become so enormous, however, the percent of total outlays contributed by private foundations is very small.

Let me put foundation expenditures in the context of total health expenditures and those of overall private philanthropy in health. National health expenditures in this country totaled $321 billion in 1982.

Figure 1 shows that 42.4 percent of those expenditures were by government. An additional 55 percent came from private health insurance and personal, out-of-pocket, and other private expenditures. Only 2.6 percent--about $8.4 billion--of the total health outlay was provided by private philanthropic giving from all sources.

FIGURE 1

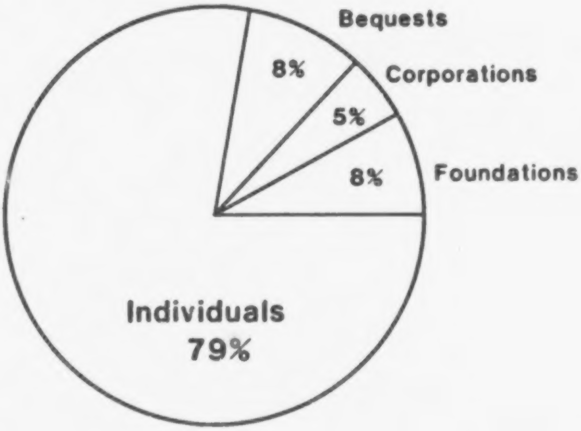
SOURCES OF NATIONAL HEALTH EXPENDITURES
1982
($321 Billion)



As you can see in Figure 2, private foundations accounted for only an estimated eight percent of that $8.4 billion. Returning to the reference point of national health expenditures shown in Figure 1, it follows that private foundation grants account for about two-tenths of one percent of that total.

FIGURE 2

SOURCES OF PHILANTHROPIC GIVING EXTRAPOLATED FOR HEALTH
1982
($8.4 Billion)



It should also be noted that despite the fact that foundations are steadily increasing the number of their dollars devoted to improving health and medical care, their share of the total national health expenditures shrinks yearly because of the speed of escalation of health care costs in our nation. A recent Georgetown University study found that between 1975 and 1980, representative groups of 276 private foundations increased their health grantmaking from $183 million to $220 million, a 20 percent change. During this same period, however, national health expenditures increased by 88 percent. This is a trend that is likely to continue in the foreseeable future.

3. Given the amount that foundations expend in health, what roles can these institutions play that is different from those of the public sector?

Given the fact that private foundations are but tiny players on this stage, many thoughtful people have asked if indeed there is any real role for them in health affairs. My review leads me to believe that there is.

First, the public sector, of necessity, must put most of its resources onto the immediate, pressing health needs of today. Almost 80 percent of those dollars go to bringing needed medical care to the less fortunate in our society. As a result, the nation can invest only a small share of public funds in programs that might answer the health care needs of tomorrow. This suggests that foundation dollars, if carefully and imaginatively allocated, can be a major source of public interest venture capital. This type of capital is used to underwrite the formulation and testing of new programs and ideas that might make care of the future more effective or less expensive. Such funds are commonly referred to as "seed money."

Consider, for example, the concept of foster care for the frail elderly being tested with foundation assistance by The Johns Hopkins Hospital. A cadre of volunteers trained by the Hospital is paid a modest stipend and given medical and social-service back-up. Each takes into their home and cares for one or two elderly patients who can leave the hospital but cannot yet manage on their own and would otherwise have to enter a nursing home.

Second, while the federal record in support of basic biomedical research is superb, government has understandable problems in financing even limited-scale experiments which might change or improve the ways we deliver medical care, or train health professionals, or organize to get the job done in many other sensitive areas of health affairs. Here, government must await a popular mandate while a foundation can help fund some new ventures so that the nation can examine their worth.

Between 1967 and 1977, for example, the Frontier Nursing Service in Kentucky, with foundation assistance, succeeded in markedly reducing infant deaths in a poverty-striken, remote, rural area by an organized system of nurse and midwife care. In fact, their infant mortality dropped below that in the rest of the state.

Third, a new idea that needs testing stands a better chance of survival in a social system with many points of initiative and decision-making, despite the apparent untidiness of such a system. In a society with an imaginative and responsible private philanthropy, individuals and groups with a potentially important new idea about how to improve our world have many possible sources to turn to for funding. While the government or even several foundations may say "no" to a particular idea, one foundation may support it. As a country, we pride ourselves in this pluralistic approach to problem solving.

Fourth, because of the extraordinary costs incurred in the financing of health services, proper concerns about containing these costs understandably make it more difficult for the public sector to give similar attention to upgrading the quality of medical care. Foundations are particularly well suited to move in this area. They also are able to provide opportunities for individualized, locally tailored initiatives or for programs that focus selectively on the critical needs of groups that may represent small percentages of the total population, but which may include as many as several million people nationally.

Foundations, to cite one example, have been out front in helping to launch and sustain the concept of advanced clinical training for nurses in a wide range or specialties. Nurses so trained have been key to the development of intensive care and other hospital special care units that have made substantial improvements in the quality of care for "critical" patients. The foundation role in community tailored initiatives and the needs of special groups can be illustrated by a foundation-funded program to consolidate previously fragmented health services for teenagers at high risk of venereal disease, suicide, alcoholism and other serious problems. Hospitals and scores of voluntary and public agencies in 18 cities are participating and have tailored programs to the particular needs of high-risk young people in their communities. Prior to this program, however, there was little recognition that these young people are the only age group in our population with a rising death rate.

Finally, foundations can provide for continuity of ideas. Key policy-making officials change with each administration or even during a single administration. There have been, for example, eight secretaries of Health, Education and Welfare and now Health and Human Services, since the Tax Reform Act of 1969. This often means that the planning starts over and over again with new policy formulations by new officials with new priorities. Fine ideas sometimes get left behind, not because they are deemed worthless, but because they get laid aside during a change of administrators and must consequently be rediscovered some years later. The Institute of Medicine, The Brookings Institute, and American Enterprise Institute are three of a number of institutions that serve, in part with foundation support, to keep health policy ideas across the full political spectrum alive and subject to rigorous analysis and thoughtful debate.

Private foundations, with their special advantages of being able to look toward the future, represent an alternative source of support for some long-range or visionary ideas which may add to the quality of American life for the generations that follow us.

4. How well are private foundations performing their roles?

In the light of the foregoing, let me expand this, my last question, to ask: how well are foundations performing their "investment in the future" role? As you may expect from what I have already said, my answer is , "Quite well." Let me elaborate on this.

The Georgetown University study I mentioned previously found that the large foundations allocated their 1980 health grant dollars among the following types of recipients:

- 42.2 percent to academic health center institutions
- 24.0 percent to hospitals
- 8.6 percent to independent biomedical and policy research institutes
- 5.4 percent to clinics, nursing homes, and other treatment centers
- 5.2 percent to professional organizations
- 5.3 percent to national and local voluntary health agencies
- 3.8 percent to public agencies
- 5.5 percent to religious and other organizations

Looking behind these figures, what were these dollars asked to do? The Georgetown researchers found that these grant funds were given primarily to explore tough, long-range problems. Only 6.2 percent went for the straight delivery of current medical services. The remaining 93.8 percent went to investments in the future: research, 23.5 percent; health services planning and development, 20.5 percent; health professional education and training, 25.3 percent; and construction and equipment, 24.5 percent.

These figures are consistent with other studies which have shown that 89 cents of every private foundation health dollar goes into long-term efforts to improve the organization and delivery of health services, or manpower training, or medical and policy research, or new facility construction. This stands in sharp contrast with federal spending in health where 79 cents of every federal health dollar goes to meet the immediate pressing health needs of today.

If you accept my thesis that private foundations should be "future-oriented" and sources of seed money for the formulation and testing of new programs and ideas, I think you will conclude with me that private foundations are right on target.

The record of returns stemming from this strategic approach taken by private foundations is long and impressive. All of you are familiar with the "green revolution" story of the Rockefeller Foundation, the eradication of pellagra and hookworm from our Southern states, or the development of the polio vaccine. Those advances were to a significant degree the result of private foundation funding. In more recent times, programs for the prevention and treatment of child abuse, the establishment of regionalized emergency services, the development of health maintenance organizations by academic medical centers, and the education of dental students to care for handicapped patients all represent foundation-supported programs developed since the Tax Reform Act of 1969.

Foundations and other private sources can also make some important contributions in other areas where public funds are lacking. Private philanthropy, for example, is a major source of funds for community-sponsored, out-of-hospital medical care programs. Almost 56 percent of all philanthropic dollars for personal health care go for the payment of visiting nurses, or mental health workers, or home care visitors, and for other services delivered outside of hospitals and nursing homes.

Foundation dollars also sometime add a missing link in publicly financed programs. Foundation grants, for example, have enabled the health departments of 10 states to do some fundamentally different things than ever tried before to organize and strengthen federally financed service programs targeted on remote rural areas which have had disturbingly high infant mortality rates and poor prenatal care for expectant mothers.

Similarly, foundations are often the source of "critical glue" required to underwrite losses of hospitals and clinics that serve low-income patients who often do not have adequate governmental or private insurance coverage. For example, in Houston, Fort Worth, Flint, Anchorage, and Kansas City, a total of 63 foundations and corporate givers have joined together in a funding partners program to bring primary care services to the poorest and most underserved people in these communities.

People in the public and private sectors alike are acutely aware that rising costs are our number one health care problem. They threaten the gains made since the mid-60s in improving people's access to health care in this country. The share of personal health care expenditures for the average family in 1980 was $2,850. If current trends continue, it could be $4,917 by 1985, and more than $8,000 by 1990. Already we are seeing the percentage of poor and near-poor Americans covered by Medicaid dropping as the costs in this federal-state program have skyrocketed.

Foundations have taken a leading role in supporting some imaginative, highly competent groups across the country seeking to find ways to slow the rate of health cost increases. Mr. Chairman, I would like to submit for the record a recent article from Foundation News that describes some of these efforts.

There are two other health areas in which private foundations have made, and continue to make, vital contributions. One is the support of a variety of programs aimed at increasing the number of minority health professionals in this country. Suffice it to say that the largest share of funds targeted for this purpose has historically come from private foundations.

The other area is the production and dissemination of new knowledge about health care--the results of hundreds of studies and program evaluations. Such information has been used to inform the health professions and add substance to the public debate on most of the major health issues of the past 50 or more years. Recent foundation-supported programs have ranged widely over the field, from programs to identify the factors in emergency medical response that are vital to the survival of heart attack victims, to studies of American's access to health care, to studies of regionalized perinatal care centers to be sure that the new medical technologies enabling low birthweight infants to survive are not increasing the number of babies with major health impairments.

Paul Ylvisaker, with the personal perspective of public and foundation service, has called foundations "society's passing gear." I think that's a good way to put it. Let me quote him a little further:

> Congestion is a predictable hazard of a society based on negotiated consent and multiple vetoes--a healthy society will have the forethought and tolerance of providing "ways out." Philanthropy is one. . . .It is a welcome addition to the diversity of this country, an alternate mechanism for doing things, an alternate way of looking at issues. It makes American pluralism even richer and much more possible to operate.

In every category of health grantmaking that I have mentioned--and in the others that I have not had time to cover--there are scores of examples of specific programs and projects that could be cited. However, I can sum up by saying that I am confident that an impartial examination of the record will show that private foundations have played and are playing crucial roles in helping to improve health and health care. I believe the American people have been and are being well served by the health activities of these institutions.

I would close, Mr. Chairman, with an endorsement of James Joseph's statement earlier in this hearing, and most particularly the Council on Foundation's support of H.R. 3043 and its opposition to the repeal of excess business holdings provisions of the Tax Reform Act of 1969. I do this on behalf of The Robert Wood Johnson Foundation, as chairman of the board of the Council, and as an individual citizen committed to the principles of private philanthropy working productively in the public interest.

Thank you.

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*The $655 million for health represents 20.8 percent of all foundation giving in 1982, which was $3.15 billion (source: Giving USA, 1983 Annual Report. New York: American Association of Fund-Raising Counsel, Inc., 1983). The 20.8 percent is the percentage of giving to health reported to the Foundation Center by participating private foundations. For the purposes of our calculations, then, we assume those foundations that do not report to the Center allocate their grants in the same proportions as those that do.

TAMING THE COST OF HEALTH CARE

Foundations Are Playing A Key Role in Efforts to Contain the Skyrocketing Cost of Health Care

By Walter J. Unger

If you were hospitalized five years ago. and you remained for an average stay, your hospital bill would have been $1,353.

If you underwent that same hospitalization today, your bill would be $2.240—an increase of 66 percent.

Indeed, in every year since the Great Depression, the cost of health care has increased faster than the rate of economic growth in the United States. In the 1940s, about four percent of America's gross national product (GNP) was devoted to health care. That figure climbed to six percent by 1965, and has risen today to fully one-tenth of our GNP—or some $300 billion.

Illustrating the problem in more comprehensive terms, Dr. David E. Rogers, president of the Robert Wood Johnson Foundation, explains that "The share of personal health care expenditures for the average family in 1980 was $2,850. Following current trends, it could be $4,917 by 1985, and more than $8,000 by 1990."

While overall medical costs have tripled since 1957, and hospital room charges have quintupled, most consumers have been insulated from the full brunt of these increases due to the enormous growth of health insurance coverage.

The number of Americans protected by health insurance has grown from only seven percent of the population in1940 to about 90 percent today. The extent of the coverage, moreover, has broadened dramatically from the early hospital and surgical expense policies. Today, coverage extends to everything from drugs and ambulatory care to dental and vision care, psychiatric services, home health services, preventive care and family planning services.

Insurance lowers the out of pocket cost of health care for the consumer, but it also eliminates many incentives for the health care provider to conserve in the use of services. Combined with rising personal incomes, this has obviously created powerful inducements for the increased consumption of health services.

"The incentives," says Dr. Robert J. Glaser, president of the Henry J. Kaiser Family Foundation, "are all on the wrong side of the ledger. What we need is an inspired tripartite effort on the part of the public, the medical profession, and those who pay for most of the benefits."

There are other major impediments to cost control besides health insurance disincentives. Says Robert A. De Vries, program director at the W.K. Kellogg Foundation, which has sponsored several demonstrations of hospital efficiency, "Leading causes of health care cost increases include duplication of services, lack of coordinated community medical care, advances in medical technology, inefficient use of personnel, inflation, and lack of incentives for containing costs. Ways must be found to contain costs through the reorganization or consolidation of services, with emphasis on a coordinated, community-wide approach."

Consumption has also been stimulated by an aging population, a greater availability of health personnel and facilities, and even by the increase in malpractice litigation—which moves some doctors to take extra steps just as a precaution in case of lawsuits. The increasing burden of long-term chronic illness has also played a role.

Taken together, these factors have propelled a six-fold increase in total national health care expenditures in the past 15 years; from $51 billion in 1967 to over $300 billion this year.

Even more alarming, the rate of health care cost increases has accelerated still faster in the last two years. Spending soared by more than 15 percent per annum in 1980 and 1981, the highest rate in the past 15 years. Total health expenditures jumped from $215 billion in 1979 to $287 billion last year.

Margaret Mahoney, president of the Commonwealth Fund, points out that "Those responsible for providing medical services are coming to see that, regardless of what political developments the next few years bring, they will have to pursue a course that is radically different from the one they followed when financial resources were abundant. They will need to develop strategies for making the most of what they have now, and responsibly plan and organize for a future in which they will face diminishing largess but no diminishment in the expectations or needs of the people they serve."

If constructive solutions do not take hold relatively soon, the financial solvency of the Medicare and Medicaid programs—along with commercial health insurance and Blue Cross-Blue Shield plans—is seriously threatened. Furthermore, says Robert Wood Johnson's David Rogers, "Unless constructive ways are found to slow this rate of increase, we risk undoing the tremendous gains that have been made in people's access to care over the past 10 to 15 years."

> "We risk undoing the tremendous gains that have been made in people's access to health care over the past 10 to 15 years."
>
> —Dr. David E. Rogers

Role of Philanthropy. A *Foundation News* survey of the foundation community indicates that a high priority is attached to the problem of health care cost containment. Foundations are addressing the problem along five major avenues:

- Innovations in the organization and financing of health care.
- Research and experimentation with ways to make health care more efficient.
- Interdisciplinary health policy analysis.
- Education about cost containment for health care students, house staff, faculty and clinicians.
- Programs to prevent disease and promote healthful living habits.

The government has also been deeply involved in each of these areas, often with grant and contract activities far in excess of private foundations' capacity. But despite the disparity in financial resources, foundations are playing a role far beyond their dollar proportion, thanks to their ability to deploy seed monies and use their flexibility to maximum advantage.

Nor are foundation resources exactly minuscule. The Robert Wood Johnson Foundation alone, for example, has assets of $1.1 billion and a professional staff of 28, including many health care experts. A sizeable share of its annual grantmaking is dedicated to the problem of health care costs. Many other foundations with smaller resources are equally committed.

David E. Rogers
President
Robert Wood Johnson
Foundation

Margaret Mahoney
President
The Commonwealth Fund

Innovations in health care financing and organization. There is now widespread recognition that our current system of providing and paying for health services is flawed. As Stanford economist Alain Enthoven puts it:

> The main cause of unnecessary and unjustified increase in costs is the complex of perverse incentives inherent in our dominant financing system for health care: fee-for-service for the doctor, cost-reimbursement for the hospital, and third-party insurance to protect consumers, with premiums usually paid entirely or largely by employers or government. This system rewards providers of care with more revenue for giving more and more costly care, whether or not more is necessary or beneficial to the patient. It leaves insured consumers with little or no incentive to seek a less costly health care financing or delivery plan.[1]

To reverse these unwanted consequences, foundations are sponsoring a wide variety of approaches. For example, The Henry J. Kaiser Family Foundation in Menlo Park, California, has made a major commitment to support the development and expansion of health maintenance organizations (HMOs). HMOs have been shown to provide health care of comparable quality at lower cost than traditional fee-for-service coverage.

Because HMOs offer comprehensive prepaid health care for a fixed annual fee, they have incentives to provide the most effective medical care obtainable within their set budget. Consequently, they tend to emphasize ambulatory and preventive care over costly hospitalization.

A variation of the HMO concept, known as "primary care networks," is being tested in four foundation-funded experiments involving state medical assistance programs for the poor and disabled. In each of these experiments, a primary care physician agrees to be responsible for the Medicaid beneficiary's entire medical needs, in exchange for a fixed payment for each beneficiary. Thus, the plan creates incentives for physicians—who control decisions affecting about 70 percent of total health care costs—to be more cost conscious.

"The incentives are all on the wrong side of the ledger."

—Dr. Robert J. Glaser

Primary care networks are being formed in Santa Barbara, Monterey and San Bernardino Counties in California, with assistance from The John A. Hartford Foundation of New York City; in Tennessee, with support from The Commonwealth Fund of New York City, The Robert Wood Johnson Foundation of Princeton, New Jersey and the Lyndhurst Foundation of Chattanooga; in Boston, with support from Commonwealth and Hartford, and in Bronx, New York, with support from Commonwealth.

The Hartford Foundation is also funding a test of per capita payments to hospitals. Under this experiment, Blue Cross is working with select hospital managers in Massachusetts and North Dakota to develop more efficient and effective means for delivering care to their patients and communities.

And in Rochester, New York, Hartford is supporting an experimental program in which the annual operating budgets for the community's nine hospitals are prospectively determined by a newly created voluntary agency. This gives hospitals incentives to control their expenditures and to work together to avoid unnecessary duplication of service.

The important characteristic shared by HMOs and each of these experiments is that health care providers are placed at financial risk for the consequences of their actions.

To stimulate more such valuable community initiatives, the Robert Wood Johnson Foundation launched "Community Programs for Affordable Health Care" last February. Grants will be made next year to assist up to 10 communities to initiate projects to slow the rate of increase in health care costs.

In addition to stimulating more per capita and prospective payment demonstrations, Johnson hopes to encourage two other developments: the restructuring of insurance benefits to make consumers and providers more sensitive to price, and the expansion and use of primary care, home care and other cost-efficient delivery mechanisms.

Johnson also expects to foster community-wide programs aimed at closing, converting or merging health services and facilities; regionalizing high technology, high-cost services such as open-heart surgery, burn units and laboratory services; encouraging alternatives to institutional care; and improving cost-efficient clinical practice.

A major goal of the Johnson program is to demonstrate the ability of hospitals, health insurers and the medical profession to work with business, labor and others to carry out broad-based local projects, the most promising of which other communities could consider.

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[1] Enthoven, A.C., "Health care costs: Why regulation fails, why competition works, how to get there from here," *National Journal*, May 28, 1979.

One of the earliest of these coalitions was the Utah Health Cost Management Foundation. In its work to stimulate competition and revitalize traditional market forces in Utah, it has helped to control costs by making price and efficiency more important factors in consumer and provider decisions.

Through its focus on improvements in the design and administration of conventional indemnity insurance plans, provision of information to the community on cost containment, and promotion of competition among HMOs and preferred provider plans, the Utah program has generated continued public pressure for health cost containment and become a model for other developing coalitions. John Billings, who directed the agency in 1980 and 1981, was recently appointed the new executive director of the John A. Hartford Foundation.

Two other organizational developments are noteworthy. Aided by grants from several foundations, over 100 "birth centers" have opened to provide maternity services outside of hospitals. Designed to serve women who expect normal pregnancy and delivery, these centers achieve significant cost savings. The Maternity Center Association in New York city operates one of the first and most successful of these birth centers.

Another alternative to hospital care is hospice care, a new type of specialized assistance to terminally ill patients and their families. Hospices focus on relieving pain, maintaining the patient's normal daily activities and supporting patients' families, rather than providing extraordinary measures to sustain life. While many individuals believe that hospices offer cost-effective care, concrete evidence has yet to be established. Consequently the Johnson and Hartford foundations, in cooperation with the federal government, are funding a comprehensive national evaluation of hospices.

Health Services Research. "Incredible as it may seem," says David Rogers, "there is no real way to measure the human benefits of most of our nation's multi-billion-dollar health expenditures. We simply lack the data needed for rational discussions about the direction, magnitude, and nature of our major investments in medical and health care nationally."

Robert J. Glaser
President
The Henry J. Kaiser
Family Foundation

Robert De Vries
Program Director
W. K. Kellogg Foundation

To fill this void, several foundations are sponsoring a diverse array of research and demonstration projects on personal health and medical care practice. A series of Robert Wood Johnson Foundation grants is exploring answers to such questions as: what can medical care do to restore people, when they are physically or mentally below par, to their maximum potential function? How well or poorly are patients with chronic illness able to perform the routine functions of daily living? Which functional deficiencies are amenable to clinical intervention? Do some interventions do better at less cost? Do certain health professionals do better than others? Can individuals at risk of developing a severe, long-term disability be identified, and can resources be devoted to preventing or minimizing their hazard of developing limitations? Answers to these questions hold the potential for carrying the nation a lot closer to the objective of making health care more efficient and less costly.

The John A. Hartford Foundation is financing a Clinical Efficacy Assessment Project at the American College of Physicians that seeks to find answers to an equally tough set of questions: among the thousands of new tests, procedures and interventions introduced into clinical practice in recent years, which ones are safe, efficacious and effective? Have older diagnostic and therapeutic techniques been superseded by newer procedures?

As a specific example of how this type of research can help reduce costs, the American Cancer Society changed its recommendations in 1980 on the use of cancer screening tests, a move estimated to be saving several billion dollars each year. Based on the work of the Henry J. Kaiser Family Foundation's Program for the Analysis of Clinical Policies at Stanford University, the American Cancer Society recommended that a Pap test need not be done every year, but can be done every three years, provided a woman has had two initial annual negative exams.

Also as a result of the Kaiser study, the age at which people should be screened for colorectal cancer was increased from 40 to 50, and the frequency of sigmoidoscopic examinations was changed from annual to every three to five years. Finally, it was decided there is insufficient evidence of benefit to justify recommending that all smokers receive annual chest x-rays or sputum cytology tests.

At Massachusetts General Hospital in Boston, a Medical Practices Evaluation Unit has been established with grants from the Milbank Memorial Fund and the Hartford and Johnson foundations. The Unit's initial research seeks to determine the effectiveness and efficiency of intensive care units (ICUs) in hospitals.

ICUs have gained wide acceptance as a general response to critical illness, despite their unproved effectiveness. ICU care is extremely costly (typically accounting for 15 to 20 percent of all hospital costs) and growing more rapidly than other hospital costs.

Retrospective studies of ICU patients have shown that most of them required only noninvasive monitoring at the time of admission, and that few of these patients subsequently required major intervention. Consequently, significant savings could be achieved by early identification of patients who will benefit from intensive care and those for whom it is not really necessary. Lacking this information, physicians are reluctant to withhold intensive care, regardless of cost, even when the probability of benefit is small.

With support from the W.K. Kellogg Foundation of Battle Creek, Michigan, the Johns Hopkins Hospital in Baltimore is studying the use of technology within the hospital. Hopkins is also attempting to ascertain why health care approaches vary for patients having the same diagnosis.

Also at Hopkins, with support from the Pew Memorial Trust, a "severity of illness index" is being developed, aiming to differentiate and quantify the burden of illness that is being presented to the hospital. The index will make it possible to compare the relative efficiency of hospitals and physicians.

The Commonwealth Fund of New York city is supporting similar work in a number of other research centers. For example, with Commonwealth assistance, the Rand Corporation in Santa Monica, California, is attempting to develop a way to use clinical data and expert judgment to identify specific instances in which the use of medical services could be reduced without impairing the quality of care.

Grantmakers In Health: A Clearinghouse For Information and Action

After four years of informal meetings involving foundations and corporations with interests in health philanthropy, Grantmakers in Health opened its doors in New York city last January. "Grantmakers in Health," says executive director Catherine E. McDermott, who formerly served as a staff officer of The Robert Wood Johnson Foundation and the Carnegie Corporation of New York, "is designed to meet the ongoing educational and communications needs of the nation's foundations and corporations engaged in health philanthropy."

The organization's primary goal, says McDermott, is "to develop programs designed to better utilize health planning dollars and to act as a strategic private-sector resource for considering possible solutions to key problems in health and medical care on national, regional and local levels." Secondarily, "collaborative planning and funding opportunities could be developed to address programs that are too large or complex for a single foundation or corporation."

"Since we represent different organizations with different mandates and resources," McDermott continues, "we have no authority nor any reason to pressure any foundation or corporation to change its grantmaking philosophy or patterns. Nevertheless, through a collective exploration of the critical issues surrounding health care systems, we hope to identify more innovative ways in which to address these questions."

The problem of health care cost containment is a high priority for grantmakers, adds McDermott, because of its "enormously pervasive influence on future directions and plans in the health care field."

Grantmakers in Health is located at 70 West 40th Street, New York, N.Y. 10018.

And Yale University researchers are studying ways to make physicians' observations a more important source of information for medical diagnosis and thereby reduce the physician's reliance on medical testing. Evaluations of occupational alcoholism treatment programs are being conducted at Boston University and Johns Hopkins University, both with Commonwealth support.

Commonwealth and Hartford are also supporting researchers at the Dartmouth Medical School in Hanover, New Hampshire, who have demonstrated that the amount and cost of hospital treatment in a community have more to do with the number of physicians there, their medical specialties and the procedures they prefer, than with the health of the residents. While this has been long suspected, hard evidence was for the most part lacking.

The W.K. Kellogg Foundation is also funding several initiatives aimed at improving hospital productivity and management systems. A grant to the Lutheran Hospital Society of Southern California is attempting to adapt successful management techniques employed by business and industry for use in the health care field. Once successful management practices are identified, they will be field-tested in four hospitals. The lessons learned from this experience will be incorporated into university programs in health administration and shared with other hospitals.

> "We have under-invested in programs for disease prevention and health promotion. Both are minuscule compared with support given to high-technology care."
>
> —Dr. David Hamburg

David A. Hamburg
President
Carnegie Corporation of New York

Kellogg and The Duke Endowment of Charlotte, North Carolina, are jointly funding a national planning, budgeting and control system to improve the efficiency and quality of hospital service. Through the integration of clinical and administrative data, this system will enable physicians to be more aware of the implications of their treatment decisions upon overall hospital operations, and will assist administrators to achieve better monitoring and control over the cost effectiveness of patient care.

Improving hospital operational efficiency and cost effectiveness is also the goal of Ohio Hospital Management Services of Columbus, Ohio. With support from the Armco Foundation of Dayton and others, this organization has provided management engineering and productivity studies for three-fourths of Ohio's hospitals.

Health Policy Development. Recognizing the need for a multidisciplinary approach to analyzing health policy issues, the Institute of Medicine was created in 1970 by the National Academy of Sciences. Until its formation, there was no broadly representative private organization to aid in health policy formulation.

With major financial support from the Commonwealth, Johnson, Kellogg, Andrew W. Mellon, Richard King Mellon, Rockefeller and Kaiser Family foundations, the Institute of Medicine quickly became a major national resource for reasoned analysis, authoritative advice, and impartial judgment on the problems of health and medicine.

Many of the Institute of Medicine's projects have dealt with the problem

John G. Freymann
President
National Fund for Medical Education

of rising health care costs. For example, in 1974 it recommended giving HMOs a fair market test. In the mid-1970s, it analyzed Medicare and Medicaid reimbursement policies, a "categorical catastrophic illness" approach to national health insurance, and methods for controlling the supply of hospital beds for acute care.

Later, the Institute provided policy advice on such topics as compensation for medical injuries, computed tomographic scanning, assessing health care quality, avoiding functional dependence among the elderly, poliomyelitis vaccines, mental health services, primary health care manpower, and health promotion and disease prevention.

More recently, the Institute has published reports on health planning and certificate-of-need programs and on integrating health services at the community level. Currently, it is studying cost-effective medical care professional and ethical concerns in for-profit enterprise in health care, and ways of developing a joint public-private sector activity for medical technology assessment.

The Institute of Medicine's creation spawned the development of several dozen health policy centers in universities and other research settings. Recently, the Pew Memorial Trust of Philadelphia, Pennsylvania, provided major support to five of these: the American Enterprise Institute for Public Policy Research, the University of California at San Francisco, the University of Michigan, and two joint endeavors, one at Boston and Brandeis universities and the other at The Rand Corporation and the University of California at Los Angeles.

In 1980, with the assistance of 10 foundations, Harvard University created a Division of Health Policy Research and Education to overcome barriers between disciplines and schools involved in health policy. The division was directed by David A. Hamburg, who had served from 1975-1980 as the President of the Institute of Medicine.

> **M**any believe that hospices offer cost-effective care, but no concrete evidence has yet been established.

Dr. Hamburg, who this month succeeds Alan Pifer as president of the Carnegie Corporation of New York, wrote a succinct summary last spring of another aspect of the health cost problem that is gaining increasing recognition.

"We have missed valuable opportunities to reduce our burden of illness by underinvesting in programs for disease prevention and health promotion," said Hamburg, writing in the June, 1982 Progress Report of Harvard's Division of Health Policy Research and Education. "Over the last decade it has become increasingly clear that cardiovascular disease, cancer, stroke and accidents—which together account for nearly 70 percent of deaths annually—are intimately linked to a variety of health-damaging behaviors, ranging from cigarette smoking to drunk-driving to sedentary lifestyle.

"Yet," continued Hamburg, "policy has not matched understanding: while support for disease prevention is growing, it is minuscule compared with the support given to high technology care.

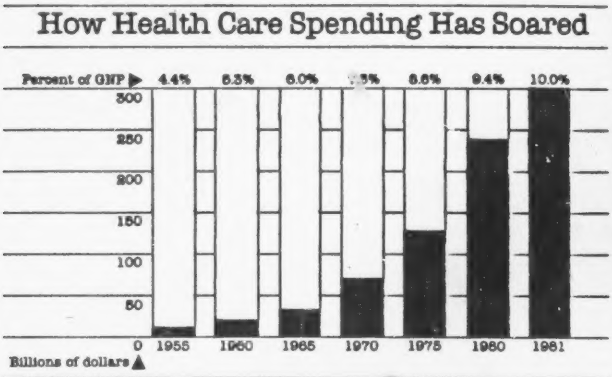
"Similarly, we have invested very little in evaluating our proliferating new medical technologies to determine their effectiveness and cost-efficiency," said Hamburg. "And recently there has been an erosion in government support for health science research, which has contributed so much to medicine's dramatic progress since World War II."

Cost Containment Education. Recognition that controlling health care costs will require a massive, systematic effort has come only rather recently. One vital element in that effort was born in 1975 when the National Fund for Medical Education (NFME), a Hartford, Connecticut organization that is supported by many foundations, concluded that it was of overriding importance to teach physicians about the economic consequences of their clinical decisions.

"When the fund announced that its priority was to support education programs that will help to contain the costs of health care without compromising quality, there were none," says NFME president Dr. John G. Freymann. "Today, just seven years later, over two-thirds of all U.S. medical schools are teaching their students how to use medical resources prudently."

The very newness of this approach means that it will still be some time before results are evident. The program, says Freymann, "has made little if any impact on costs so far, but it should do so by the 1990s, because 400,000 doctors who will be practicing then are now in the educational pipeline."

On the premise that cost control begins in the minds of medical students, the Fund supports educational innovations dedicated to two propositions: that appropriate care is not necessarily the most expensive care; and that



How Health Care Spending Has Soared

An energetic form of preventive medicine, part of the new program at The Methodist Hospital in Houston, Texas.

if physicians do not assume responsibility for the use of medical resources, others will—and doctors' freedom to care for patients as they think best will be lost. While these concepts are not yet universally accepted, they are gaining a firm foothold in medical curricula.

The W.K. Kellogg Foundation has assisted in carrying these concepts to other components of the health professions, including practicing physicians, medical school faculty, dentists, nurses, nurse practitioners, physician extenders and social workers. For example, Kellogg is supporting a cost containment project with the Emergency Medicine Foundation and the American College of Emergency Physicians. This project is analyzing 40 high-cost, high-frequency laboratory tests and radiologic procedures to see if less costly methods can be used to reach a diagnosis. Educational materials and courses, based on this analysis, will then be prepared for all medical personnel involved in emergency medical care.

Prevention of Disease and Promotion of Health. While not traditionally viewed as a health care cost containment initiative, activities aimed at identifying and reducing health risks, and at restoring and perpetuating physical vitality, hold enormous potential for reducing health care costs.

In the belief that hospitals should play a major role in preventing diseases as well as curing them, The Methodist Hospital of Houston, Texas, opened an Institute for Preventive Medicine in 1981 with assistance from the Sid W. Richardson Foundation of Fort Worth, Texas.

"We must work to convince people that their health status can be dramatically improved by better eating habits, better exercise, and by giving up smoking and reducing the intake of alcohol," said U.S. Secretary of Health and Human Services Richard Schweiker, who spoke at the dedication of the new facility.

In addition to offering community educational programs on nutrition, weight control, exercise, smoking, stress management, diabetes and cardiac rehabilitation, the Institute is beginning research on the effect of preventive programs on sick leave, health insurance and productivity.

On another important new front, the Joyce Foundation of Chicago has made several grants to provide health education for vulnerable constituencies such as minorities, the poor and youth. For example, Joyce has assisted Centro Latino, a community-based organization, to provide immunization, nutrition and general health information to immigrant families.

Through a grant to the Chicago Child Care Society, Joyce is piloting an educational program in two elementary schools to prevent teenage pregnancy, a major health issue for adolescents (and one to which many foundations are heavily committed). Joyce also sponsors the Self Help Center in Evanston, which serves as a regional clearinghouse and provides technical assistance and networking for self-help groups throughout the midwest.

In summary, there is almost no aspect of the effort to gain control of today's skyrocketing health care costs that is not being supported—if not originated—with the help of America's private foundation community.

Walter Unger is a Washington-based freelance writer who specializes in medical coverage.

Mr. **Stark**. Thank you very much, Dr. Rogers.

Mr. Heyns.

STATEMENT OF ROGER W. HEYNS, PRESIDENT, THE WILLIAM AND FLORA HEWLETT FOUNDATION

Mr. **Heyns**. Thank you, Mr. Chairman.

My name is Roger Heyns, president of the William and Flora Hewlett Foundation. I have submitted testimony and I hope only to excerpt from it.

Because so much of that testimony has to do with the Hewlett Foundation I would like to make a couple of comments about it.

The foundation was established by William and Flora Hewlett in 1968 and its first professional staff came on in 1977. In that 6-year period the assets have grown from $40 million to $600 million. For 5 out of the last 6 years we have exceeded the expenditure requirement and this year we will be at that level of $30 million in grants.

There has been quite a lot of testimony, Mr. Chairman, about whether or not the 5-percent expenditure requirement has actually become the ceiling and there are some data provided by the Foundations Center which indicate very clearly that the foundations have exceeded that number and it has not become the ceiling. Our administrative costs are about 7 percent and this, too, has been subject of discussion before the committee. There are again data on administrative costs provided by the Council on Foundations and the Foundation Center. Depending on the population segment you look at, the numbers vary because smaller foundations have a higher proportion of their assets in administrative costs but in the larger ones the average administrative budget is around 10 percent.

Our grants from the Hewlett Foundation are in four principal areas: education, environment, performing arts, population, and then a fifth which we call the regional grants program which contains social support activities of the foundation.

I mention these program areas because there has been some discussion about the ways in which the committee can get at the question of recipients of foundation grants. You can tell from the classification system I just gave you that one cannot derive at all who the recipients of those grants are and in what areas. Nor can one derive the answer to questions about recipients necessarily from the names of organizations.

I think that a serious effort to determine the final recipients of help from foundations probably ought to be made but I believe that looking at the classification systems foundations use or the names of organizations that are listed as grantees are very imperfect ways of arriving at that number. One can make grants to community development organizations but one would have to do a good deal of extra work to discover that Asian, Mexican-American, Chinese, blacks and others have been the final beneficiaries.

I treated two subjects in my written testimony, Mr. Chairman, the first was the role of foundations with respect to the current economic difficulties and the cutback in Federal funds. While foundations cannot clearly, as Mr. Joseph pointed out, meet the gap caused by the decrease in Federal funding, they have certainly not continued to conduct their business as usual. We, and I think we are not uncharacteristic, would classify our responses to the crises in three categories: first of all emergency grants where we dealt very specifically with unexpected, unintended and certainly severe malfunctions in the system. In our case along with the other foundations in northern California we established a $2 million fund to help particularly families who were having trouble in keeping the family intact with respect to their housing.

That is just one example of an emergency response and there are others in my testimony.

The second response has been to help social organizations, social service agencies, those that face the impending decrease in support from public sources, become more effective through improved managements, increased funding capacity to broaden their base of support. We also made grants to encourage volunteers, improving the agency's effectiveness in the use of volunteers.

Another category of response to the current crises has dealt with more basic problems which were there before the current crisis but are accentuated by our economic difficulties.

I will give you three examples of that. We have accelerated our interest in the generic, structural problem of youth unemployment. We have also increased our efforts to help community development organizations. Many of these are very dependent on Federal assistance and other public sources. In the last 2 years we have granted $1 million to a dozen such community development organizations which have demonstrated their effectiveness in responding to community needs.

Another basic problem that we have attended to is the problem of unwanted teenage pregnancies. In the last 2 years we have granted about $830,000 to six organizations providng sex education to these young people.

In my dealing with the second topic that was assigned to me, the foundations' role in education, there are lots of examples in my testimony. We, like most foundations, contribute a large proportion of our annual grant budget to education. In our case, higher education up until recently was the principal focus.

In order to stay within my time limit let me just say that by and large we have interested ourselves in institution building. Rather than respond to immediate operating needs but rather to bill capacity in our educational institutions.

We have concerned ourselves with a range of institutions: research universities, private liberal arts colleges, and we have, along with the Bush Foundation of St. Paul, Minn. established a program for support of the predominantly black institutions to help them complete their capital campaigns.

We also made grants in important subject matter areas. We have a deep belief that in working with problems of the libraries in research universities we are also helping the library system of the Nation. Libraries are an important educational element in our Nation and we together with nine other foundations have been helping the Council on Library Resources to establish a national bibliographic network. This network will be useful to all libraries, including the Library of Congress.

We have assisted in the development of our Nation's competence in international scholarship and training. Through grants international studies centers on 12 campuses. We have made several grants to organizations devoted to increasing public understanding of international affairs. Most recently made a grant, the purpose of which was to increase public understanding of national security issues, one of a number contemplated.

One of our programs, begun 6 years ago, had the purpose of increasing the number of minorities in science and engineering. In that time, the project established relationship between 19 colleges and universities and 100 high schools adjacent to those institutions. Three thousand 10th and 11th grade students were in the program last year. More than 90 percent of the graduates who went on to college have gone into majors in mathematics and science.

In short, Mr. Chairman, we are attempting to help a wide range of problems and institutions. Let me, finally, mention our efforts with respect to the public schools. We are joining lots of others in a concerted effort to help with our problems in public education. Our particular direction has been to improve the quality of the relationships between school districts and the universities, particularly schools of education in order that the resources of the university can be made available in a more direct and effective way to the administrators and teachers of the local schools.

I think that completes my testimony, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF ROGER W. HEYNS, PRESIDENT, THE WILLIAM AND FLORA HEWLETT FOUNDATION

Let me begin by thanking the Committee for conducting this oversight of private foundations and for extending me the privilege of presenting testimony.

I have been asked to discuss two topics: first, the response of foundations to the current economic downturn and the cutback in federal resources for the social services; second, the role of private foundations in the field of education. With respect to both of these topics, I will, for the most part, limit my remarks to the programs of the William and Flora Hewlett Foundation. This approach has some disadvantages since it does not provide a summary picture of foundations in general. I assume, however, that the Council on Foundations can provide the Committee with statistical data describing the foundation community in these areas. Limiting myself to the programs of the Hewlett Foundation permits me to be specific about our programs, our purposes, and our current impressions as to their effectiveness. Although I will talk primarily about one foundation, I do not believe that we are unique; in one way or another, although not without exceptions, you will find many other foundations that have responded in much the same fashion.

FOUNDATION RESPONSE TO THE RECESSION AND THE CUTBACK OF FEDERAL FUNDS FOR SOCIAL PROGRAMS

The foundation community made very clear early that it was not reasonable to expect that foundations, or indeed, all other segments of the philanthropic community combined would be able to fill the gap caused by the reduction in federal funding. This, I hasten to add, was not a political statement but a simple matter of arithmetic—comparing our assets with the total dollars required to fill the gap.

This reaction, probably motivated more by a fear of excessive expectations of prospective applicants than any other single factor, did not mean that we were not prepared to help or that we proposed to conduct business as usual.

Emergency grants.—The Foundation last fall recognized the housing problems of the families of unemployed workers by making grants to two agencies that provided emergency shelter, initial rental payments, and other expenses they needed to establish themselves in suitable housing. We and other foundations and corporations provided $2 million to create a fund for this purpose. The Foundation is also supporting the Bay Area Urban League's program to provide counsel and assistance to homeowners who are in danger of losing their homes through default on their mortgages.

The Foundation has, along with other foundations in the region, guaranteed support for a summer recreational program for youth in the Bay Area. It has also responded to highly specific requests for the maintenance of recreational facilities, such as a swimming pool, that needed to be repaired for it to be useful to the local recreation program.

Longer term responses.—The Foundation assumed several years ago that the nation was in the process of reexamining its priorities and that, whether one agreed with the trend or not, there was going to be a reallocation of responsibilities for many functions from the federal to other levels of government and from governmental to private support. We regarded it as our responsibility to help make that process effective and to reduce the human costs that are inevitable of this transition.

The Foundation, as long as six years ago, recognized that many nonprofit organizations needed help to improve their management. Their Boards are often ineffective and unclear about their functions; the organizations frequently suffered from differences between staff and Board as to the purpose of the organization; their financial and personnel policies are less effective than is desirable. Accordingly, the Foundation has made grants to increase organizational effectiveness, grants to provide management training, efforts to increase the effectiveness of Boards, and to support long-range planning activities. These grants have been made to individual organizations, as well as to agencies that provide management services to these groups. We have also supported several organizations that provide the specialized knowledge and experience of retired executives to these agencies.

Because these nonprofit organizations will need to broaden their base of support and make more secure their financial future, we have made grants to meet their needs for sound financial plans and for competent fundraising capacity. An example of this type of grant is one the Foundation made to the National Family Planning and Reproductive Health Association of $210,000. Approximately half of the clinics that have received federal funding for family planning programs are members of this organization. Federal expenditures for family planning programs are estimated to be cut back about 14 percent in the next year. The Association provides services to these clinics and other organizations in the field, and these funds will support efforts to build a base of private support for the Association itself and for its members.

As with most of our grants, this has a matching requirement; the organization agrees to raise funds from new sources or increase support from existing sources. These matching conditions are not imposed by the Foundation but rather worked out in cooperation with the recipients in such a way that they are realistic and useful to them. The purposes of the matching procedure are, of course, to increase the sources of support and to encourage increased individual philanthropy.

It is clear that the continued effectiveness of these organizations which have discharged a large proportion of our social responsibilities depends upon volunteers. Forced to cut back in paid staff, they will need more nonpaid help. There is a long tradition of volunteering in the U.S.; the Independent Sector's study of volunteerism estimates that in 1981 the dollar value of time volunteered by Americans was $64.5 billion. Forty-seven percent of American adults were engaged in a structured volunteer situation. Seventy-six million adults put in an average of 102 hours of work per year. In the same year there were seventy-seven million teenage volunteers.

While these figures are impressive, more volunteering will be needed. There are some formidable problems that must be solved, however, if this increase in volunteerism is to occur. A major source of volunteers has significantly declined in recent years as women have moved from the voluntary to the paid work force. The social status of the volunteer has declined. The personnel practices of social agencies, even those heavily dependent on volunteers, leave much to be desired. The intelligence and dedication of volunteers are all too frequently ignored or underutilized, and more attention must be given to the training, motivation, and morale of the volunteer. The social contract between the agency and the volunteer is often ambiguous and not mutually rewarding. Another major problem volunteers face is the territorial protectiveness of the professionals in an agency. Many not-for-profit organizations need the skills of the trained people, and the personnel practices perhaps appropriate for the untrained volunteer are clearly not satisfactory for more accomplished volunteers. The Foundation has made a number of grants, the purpose of which has been to help solve some of these problems.

Much of what I have referred to has concerned social service organizations. It is important for all of us to remember that cultural organizations face the same problems, have the same characteristics, and need the same kinds of assistance. Most of the grants the Foundation has made to the performing arts organizations in the Bay Area have had these same objectives; management training and improvement of financial planning, broadening the base of support, and increased and more effective use of volunteers.

Finally, in this connection, the Hewlett Foundation has recognized the special sensitivity and effectiveness of the smaller community foundations in our area. At the Board of Directors meeting in April of this year, the Foundation made grants amounting to almost $1 million to three such foundations to increase their capacity to meet community needs and to increase their assets.

Basic responses.—Part of our total reaction to the current situation has been to identify three important problems that, while accentuated in the present crisis, are more basic and require long-range attention. One of these is youth unemployment, particularly in the minority groups, which is clearly caused by structural rather than cyclical factors. An example of our effort in this area is the partnership that has been formed among high technology corporations in our area, the school districts, and the foundation to establish a job training program for sixty selected tenth-grade students each year. They are trained in computer operation and electronics technology. Job training programs are, of course, not new nor are we unique among foundations in supporting them. This project is of particular interest for two reasons, however; the first is the participation of the school district and corporate community. In addition to providing instructors for the program, the corporations are guaranteeing jobs to successful graduates. Secondly, the project also includes an evaluation component. We hope a careful study of it will add to our knowledge about what makes a job training program effective.

With a similar interest in helping with more basic problems, the Foundation has in the last two years provided more than $1 million to a dozen community development organizations in the Bay Area. These organizations are based in neighborhoods and are responsive to their needs. Although while there is a wide variety of these organizations, they are all directed toward improvement of the neighborhood through such activities as economic development, improved housing, and improved social services. They have demonstrated themselves to be effective brokers between the community and agencies of government, and the more mature among them have been heavily dependent on federal funds. The Hewlett Foundation has provided start up costs for some of them, core support for key staff members, and management training opportunities for others. It is our belief that these organizations are important actors in the effort to improve the quality of life in our blighted urban neighborhoods.

A third example of the Foundation's interest in more basic social problems is provided by our attention to the problem of unwanted pregnancy among unmarried teenagers. During 1981 and 1982 the Foundation supported, for a total of $830,000, six organizations engaged in programs providing sex education and other services to adolsecent girls. This year we are supporting several efforts to evaluate our state of knowledge about how to reduce the incidence of unwanted pregnancy in this age group as well as to measure the effectiveness of some of the programs now underway.

To summarize this description of the Foundation's response to the nation's current situation, we have first attempted, along with other foundations both private and corporate, to meet emergency needs. Second, we have directed our efforts to increase the effectiveness of nonprofit social agencies and performing arts organizations. Third, we have directed our support to three important, long-range problems: youth unemployment, community development, and adolescent pregnancy.

THE FOUNDATION'S ROLE IN EDUCATION

The Hewlett Foundation, along with most other foundations large and small, devotes the largest proportion of its annual grants budget to education. In our case, this fraction is about 30 percent and this year will amount to about $8 million. Up until recently our grants have been concentrated on institutions of higher education. In general our strategy has been to increase basic strengths of institutions rather than to meet their immediate and specific needs.

Together with the Andrew Mellon Foundation, we have established a program to endow funds, the proceeds of which are to be used at the discretion of the college president to ensure the college's capacity for self-renewal despite budgetary stringencies and will be used principally for faculty and curriculum development. By the end of 1982 forty-six selective liberal arts colleges received grants totaling more than $4 million from each foundation. Since each grant has an individually negotiated matching requirement, our current estimate is that the resulting endowment funds will amount to more than $22 million.

A second category of educational institutions of special interest to the Foundation consists of private black colleges. In partnership with the Bush Foundation of St. Paul, Minnesota, we have made a joint commitment of up to $10 million to help colleges complete their capital campaigns.

With respect to research universities, our third category of educational institutions, the Foundation's assistance has been focused on these areas: research libraries, scholarly publications, and international and area studies.

Our interest in the library problems of research universities rests on the belief that only through collaboration can the major research libraries of the nation, including the Library of Congress, hope to provide services, build collections, and preserve deteriorating material without being overwhelmed by increasing costs. Accordingly, the Hewlett Foundation, along with six or seven other large foundations, has been supporting the collective efforts to build a national bibliographic network. Our support has been provided primarily through grants to the Council on Library Resources and to the Research Libraries Group. By the end of this year, our grants to this library effort will reach $2.5 million. While this description of our libraries program has been in the context of research libraries, it is clear that this effort will benefit college as well as local public libraries throughout the country.

Largely due to a far-sighted program of the Ford Foundation in the decade of the fifties, most of the major universities were able to establish important centers of international scholarly research and training. The programs are now integral parts of these institutions and are supported by university funds. Their graduates are widely dispersed as faculty in other universities and colleges. In recent years, however, support for the research and training activities of these centers has dropped off; the federal program for these purposes have not kept up with needs. To help sustain the quality of these centers, the Foundation has made grants totaling $2.7 million to fifteen universities to establish endowments for international training and research. The earnings of the endowments will be applied at the discretion of the university to maintain or increase the effectiveness of these programs.

This interest in increasing the Nation's competence in international affairs has led us to a particular interest in strengthening the teaching and research programs of American academic institutions focused on U.S.-Mexico relations. Last year the Foundation made three grants with these objectives, for a total of slightly more than $300,000.

Closely related to these efforts are several grants to improve the capacity of the general public to understand international issues. The Foundation is supporting joint efforts by the World Affairs Council, Stanford University, Global Perspective in Education, and the University of California, Berkeley, to stimulate the public's interest in and understanding of international affairs.

Since 1977 the Foundation has supported MESA (Mathematics, Engineering, Science Achievement), a program directed toward increasing the number of minority youth in the fields of engineering and science. The program is based on the cooperation of nineteen colleges and universities with more than 100 high schools in their regions. Three thousand tenth and eleventh-grade students were in the program this past school year. More than 90 percent of the graduates have gone to college, with two-thirds in math-based majors. So far the Foundation grants to MESA amount to $1,687,000.

Up until this year, MESA constituted our only effort in public schools. This year our Board authorized a program to support projects in elementary and secondary education. In making this addition, we were, of course, joining other foundations with a long-standing interest in our nation's public schools such as the Ford Foundation, the Carnegie Corporation, the Spencer Foundation, and the Charles Stewart Mott Foundation to mention only a few.

Our research to determine where we could be most helpful in the national effort to meet the problems of the public schools, now a subject of broad attention, led us to identify the need to bring the resources of universities, particularly but not exclusively their schools of education, into direct contact with nearby school districts, with the school district primarily responsible for the identification of the problems to be addressed. So far we have made a multi-year grant to a project with these characteristics, located and administered by Stanford University in partnerhip with administrators from adjacent school districts.

Finally, I want to mention the Foundation interest in the area of arms control, defense strategy, and disarmament. There is perhaps no subject in greater need of increased understanding than that of national security. The interested and concerned citizen finds himself or herself with two essentially unsatisfactory choices:

joining fellow citizens in support of an emotionally appealing posture which reflects our basic impulses but has ambiguous policy implications or being overwhelmed and confused by the arguments and terminology of defense experts. Centers independent of the defense establishment and other governmental agencies that do objective studies of security and arms control options are few in number and are undersupported. As a result, the nation is deprived of their capacity to inform policymakers and increase the understanding of these issues on the part of the public. In addition, it is clear that there is a shortage of qualified people to work in this field. As the first of several grants to meet these needs, the Foundation has made a multi-year grant of $600,000 to the Stanford University Arms Control Program for general support of its research and educational activities.

In summary, the Foundation is providing support to a variety of institutions of higher education: predominantly black colleges, liberal arts colleges, and research universities. We are part of a large effort to improve the library system of the nation and to increase our national capacity to know and understand foreign countries with a special interest in increasing our scholarly competence and public understanding of U.S.-Mexico relations. We have supported efforts to improve the education prospects of minority youth in California. We hope to be useful participants in the national effort to improve public education. Finally, we intend to help increase the nation's capacity to make wise decisions through the support of training and arms-length research in the area of national security.

FOUNDATION MANAGEMENT

I trust that it is appropriate to conclude with a few comments about the mode of operation of the Foundation. All grants made by the Foundation with the exception of small grants made at the discretion of the president (which are subject to review by the Board) are approved by the Board. While this is obviously an important function of the Board, it is not in my opinion its most important one. Its most important function is policymaking through the establishment of the areas in which the Foundation will make grants, the definition of the purposes of such grants, and stating the criteria successful proposals must meet. Once these decisions have been made, it is the task of the staff to recommend grants in the designated areas that have these purposes and meet these criteria. We have made special efforts to describe our foundation interests clearly, primarily for the benefit of prospective applications to minimize efforts on their part that are likely to be unproductive. As a consequence of these procedures we have tended to focus our efforts. This has many benefits, but it also has the unfortunate but inevitable consequence, namely that we do not support many equally worthy types of projects or programs.

Finally, in order to provide some stability, both for the Foundation and the applicant community, we have tried to maintain during the past six years relative stability in each of the programs of interest of the Foundation. However, I hasten to add that they are not inviolate or fixed forever. Each year the Board reexamines them, modifies them through extension or contraction, and determines the amount of money to be assigned to each. Additional elements to existing programs and new program interests reflect, as they properly should, the values, interests, and understanding of the Board and the competence of the staff. The central considerations that have influenced the Board in its conduct of the Foundation's affairs, have been these: Foundations are the private servants of the public interest. The Foundation's fundamental purpose, as stated by the founders, is to promote the well being of mankind. The Board's basic interest in meeting this aspiration is to make ours an effective democratic society, one whose institutions work. We believe this goal is essential to human welfare not only in the U.S. but throughout the world.

Chairman RANGEL. Thank you very much.

Mr. STARK. Mr. Chairman, I just wanted to state briefly that on page 9 of Mr. Heyns' testimony he has one statement that I think is excellent. He said the central considerations that have influenced the Board have been listed, and the first is the definition that foundations are the private servants of the public interest.

I think that is an excellent comment on that.

Mr. HEYNS. Thank you, Mr. Stark.

Mr. STARK. Thank you, Mr. Chairman.

Chairman RANGEL. Let's call Mr. Shannon.

My colleague, Mr. Martin, wants to be here for the Babcock Foundation testimony. So why don't we ask you to proceed, Mr. Shannon.

STATEMENT OF JAMES P. SHANNON, EXECUTIVE DIRECTOR, GENERAL MILLS FOUNDATION

Mr. SHANNON. Thank you, Mr. Chairman.

I am James Shannon, vice president of the General Mills Co. and executive director of the General Mills Foundation. My office and headquarters are located in Golden Valley, Minn.

I have been invited to testify concerning corporate foundations and I shall use our foundation as an illustration not to maintain that it is typical of all corporate foundations, but I would maintain that it is not atypical of well-run corporate foundations.

Corporate foundations as you have heard earlier this morning are one species of the genus "private foundation." Private foundations are defined in the Internal Revenue Code as foundations which receive the greater share of their resources from a single donor. The typical private—family—foundation receives its corpus from the estate of a single person or a family, for example, the Ford Foundation, the Rockefeller Foundation, the MacArthur Foundation, and is thus, in effect, an endowment which spends its annual income by making grants to worthwhile organizations approved by the Internal Revenue Service.

Typically, a corporate foundation pays out in grants each year money given to it by its parent company from profits realized by the company in the preceding fiscal year. Some—few—corporate foundations are funded by a lump-sum endowment from their sponsoring companies. These "endowed" corporate foundations are bound by the 5-percent annual payout rule which applies to endowed private—family—foundations. But the majority of corporate foundations, not being endowed, pay out all, or almost all, of the money they receive each year from their parent company.

In 3 of the past 5 years the General Mills Foundation has paid out more money in grants than the amount given to it by its parent company, a procedure made possible by our spending in each of those 3 years all the interest our foundation earned by temporarily investing the money between the time it was given to us by our parent company at the beginning of the year and the time we paid it out in grants during the year.

I noted from the questions earlier and I would comment that it has been the effective intention of the trustees of our foundation to increase the portion of our budget annually committed to health care and social service programs at the expense of the other three categories: Education, culture, and civic affairs.

Also, corporate foundations of publicly held companies have a special fiduciary obligation to the shareholders of their parent companies, since corporate philanthropy, in effect, distributes a portion of shareholder profits to address worthy public causes. Thus private corporate foundations, unlike private family foundations, must be prepared to tell their shareholders the rationale which justifies this disbursement of shareholder resources.

Typically, corporate foundations address this issue publicly at the annual meeting of the corporate shareholders. At the General Mills annual shareholders' meeting it is our practice to distribute both our corporate annual report and our foundation annual report and to respond to any queries posed about either of them.

I would like to comment that the line between tax supported and publicly supported public services has been clearer in the past than it has today. Our society is at present passing through a significant era of change in which many programs and services once supported by taxes will be eliminated or cut significantly unless they find new private sector sponsors.

This is an era of steadily increasing competition for private sector philanthropy. The American public has not yet reached a consensus yet about which of its traditional public services it considers essential and which it is prepared to give up or trim back. The dialog leading to such a consensus is under way but it is far from completion. It would seem these discussions are an integral part of that dialog.

According to the most recent report of the conference board and I quote:

> The private giving from all sources increased by 12.4 percent between 1980 and 1981 rising from $47.7 billion to $53.6 billion. Corporate philanthropy which represents 5.4 percent of this total increased by 11.5 percent from $2.6 billion to $2.9 billion. Corporate pre-tax profits were down by 4 percent. This is the second consecutive year in which corporate giving has increased despite the dip in profits.

Using that as a predicate for my specific response to your query about recommendations that we would suggest in your efforts to review the current validity and efficacy and reach of the Tax Reform Act, I would like to offer as my opinion that the Tax Reform Act of 1969 was timely. It has been positive, it has been effective, I submit, in addressing the problems that it was intended to address.

I would also like to go on record in favor of the pending legislation, your House Resolution No. 3043 and focus my concluding remarks particularly on the matter of the expenditure responsibility and the current excise tax.

Regarding expenditure responsibility, my experience as the chief administrator of three different foundations, a community foundation, a family foundation, and a corporate foundation, leads me to believe that the strictness of the present rule on expenditure responsibility does no injury to donor foundations like my own but does do injury to smaller and recently established, particularly minority donee organizations who are presently denied support of foundations unwilling to accept expenditure responsibility even though these same foundations would support such donee organizations if grants to them did not obligate the foundation to exercise expenditure responsibility.

It would be my recommendation in view of the urgent current need for support of the nonprofit sector that the Congress ease up on the strictness of the current rule demanding expenditure responsibility for grants to small, recently established but promising health care, educational, cultural, and social service agencies.

Second, apropos the excise tax levied on foundations by the Tax Reform Act of 1969, the Congress has already wisely decreased the level of this tax from its original 4 percent to its present 2-percent level. However, the Internal Revenue Service now collects from this tax considerably more than is needed to oversee compliance with the Tax Act of 1969. Hence, prudent tax policy would seem to dictate that this too could be reduced to whatever level is needed to pay for the IRS oversight of compliance with the Tax Reform Act of 1969.

Gentlemen, you have my testimony and it is in larger compass and I would respond to questions if that generates any.

I thank you for the courtesy of this invitation.

[The prepared statement follows:]

STATEMENT OF JAMES P. SHANNON, EXECUTIVE DIRECTOR, GENERAL MILLS FOUNDATION

My name is James P. Shannon. I am a vice president of General Mills, Inc., and Executive Director of the General Mills Foundation. My office and the headquarters of our company are located in Golden Valley, Minnesota.

I have been invited by John J. Salmon, Chief Counsel of the Ways and Means Committee to testify today concerning corporate foundations.

Corporate foundations are one species of the genus private foundation. Private foundations are defined in the Internal Revenue Code as foundations which receive the greater share of their resources from a single donor. The typical private (family) foundation receives its corpus from the estate of a single person or a family (e.g. the Ford Foundation, the Rockefeller Foundation, the MacArthur Foundation) and is thus, in effect, an endowment which spends it annual income by making grants to worthwhile organizations approved by the Internal Revenue Service.

Typically, a corporate foundation pays out in grants each year money given to it by its parent company from profits realized by the company in the preceding fiscal year. Some (few) corporate foundations are funded by a lump sum endowment from their sponsoring companies. These "endowed" corporate foundations are bound by the 5% annual pay-out rule which applies to endowed private (family) foundations. But the majority of corporate foundations, not being endowed, pay out all, or almost all, of the money they receive each year from their parent company. In three of the past five years the General Mills Foundation has paid out more money in grants than the amount given to it by its parent company (a procedure made possible by our spending in each of those three years all the interest our Foundation earned by temporarily investing the money between the time it was given to us by our parent company at the beginning of the year and the time we paid it out in grants during the year).

Most corporations in the United States do not have corporate foundations. However, many of the larger national corporations do have professionally staffed foundation offices, operated as a corporation separate from the parent corporation. I would submit that the professional standards and the administrative procedures of the General Mills Foundation are typical of the standards and procedures of the corporate foundations of larger national corporations. Hence, with your indulgence, I shall here highlight the more significant elements of our program as illustrations of typical procedures in corporate foundations.

In its current fiscal year (June 1–May 31), the General Mills Foundation plans to pay out in grants $7.2 million. Of this amount 40% will be spent for health care and social service programs; 30% for education; 15% for cultural affairs and 15% for civic affairs.

The largest single item in our annual budget is our contribution ($807,250 last year) paid to the United Way campaigns in those communities where General Mills has a significant number of employees.

In education our greatest single contribution is our employee gift matching program whereby we match, dollar for dollar, each employee's donation to any accredited college, university, secondary or technical-vocational school, public or private. Last year this line in our grants-budget totalled $440,000.

The General Mills Foundation has an administrative staff of six full-time and one part-time person. All the administrative costs of this office are paid by our parent company, to enable the Foundation to use all its funds for grantmaking.

Policy is set for our Foundation by a Board of five Trustees who are the five senior officers of General Mills, Inc. This board meets every sixty days to review and approve grants recommended by our staff and by local grants committees in those communities where our parent company has a significant number of employees.

The General Mills Foundation publishes annually a printed report stating the guidelines for its grant-making, listing the grants made in the preceding year, and counseling would-be applicants on how to apply for grants.

The letter inviting me to testify today posed 35 separate questions concerning the procedures of private foundations. I shall not try to reply to each of these queries individually but I shall do my best to respond to those which relate directly to corporate private foundations.

Private foundations, both family and corporate, play an increasingly critical role in maintaining necessary public services as public funds from the both federal and state budgets decline.

According to the Conference Board, the reported cash contributions of all corporations in the United States last year totalled slightly more than $3 billion. This is roughly 5% of the total cash contributions of all reported philanthropy in the nation. Since this is such a small percentage of our total national philanthropic budget it is important that corporate policy makers focus their giving in areas of greatest importance to society and in ways which leverage these gifts with similar gifts from all other sources, public and private.

Corporate foundations of publicly held companies have a special fiduciary obligation to the shareholders of their parent companies, since corporate philanthropy, in effect, distributes a portion of shareholder profits to address worthy public causes. Thus private corporate foundations, unlike private family foundations, must be prepared to tell their shareholders the rationale which justifies this disbursement of shareholder resources. Typically, corporate foundations address this issue publicly at the annual meeting of the corporate shareholders. At the General Mills Annual Shareholders' Meeting it is our practice to distribute both our corporate annual report and our foundation annual report and to respond to any queries posed about either of them.

Historically, the line between tax supported and privately supported public services has been clearer than it is today. Our society is at present passing through a significant era of change in which many programs and services once supported by taxes will be eliminated or cut significantly unless they find new private sector sponsors. This is an era of steadily increasing competition for private sector philanthropy. The American public has not yet reached a consensus about which of its traditional public services it considers essential and which it is prepared to give up or trim back. The dialog leading to such a consensus is underway but it still far from completion.

In this process of resolution, corporate foundations are able to play a significant role if they will carefully define the focus of their giving; state publicly the rationale for their giving; link arms with other donors, public and private; verify the value to society of the projects they support; insist on professional management in agencies they support; work to eliminate duplication and inefficiency among the agencies they support; develop monitoring procedures to identify changing needs in those communities they support and encourage their employees and retirees to assume more active roles in community affairs.

Over the past two years corporate foundations have responded flexibly and generously to the changing needs of the times and to President Reagan's several invitations to the private sector to use its resources, fiscal and human, to address high priority public needs.

According to the most recent report of the Conference Board, our most reliable recorder of statistics on corporate giving, "Private giving (from *all* sources) increased by 12.4 percent between 1980 and 1981, rising from $47.7 billion to $53.6 billion. Corporate philanthropy, which represents 5.4 percent of this total, increased by 11.5 percent, from $2.6 billion to $2.9 billion. Corporate pre-tax profits were down by 4 percent. This is the second consecutive year in which corporate giving has increased, despite a dip in profits".

Also reported by the Conference Board survey is the fact that, "In 1981, 64 percent of the foundations (reported in this survey) paid out (in grants) more than they received from their companies. Two years earlier that figure was 47 percent".

There is a discernible trend among publicly held corporations to pledge a fixed percentage of their pre-tax profits to philanthropy. In several states there are now 5 percent and 2 percent Clubs, made up of corporations that are on record as pledging these percentages of their pre-tax profits to philanthropy.

Of the 54 major companies surveyed in the Conference Board study, 40 percent had a corporate philanthropic goal of 2 percent or higher. At present General Mills, Inc., is giving 2.5 percent of its pre-tax profits to philanthropy and its corporate long-range plan calls for raising this figure by 1/10 of 1 percent a year for each of the next five years. However, in the words of the Conference Board, "Generally speaking, large companies have been more reluctant than smaller companies about setting contributions goals based on income. Although the contributions-to-income ratio is one element they consider when budgeting, it is not the determining factor. Those companies enrolled in 2 and 5 percent clubs are usually of medium and small size and locally based."

Most companies in the nation do not have a corporate foundation, preferring to make their gifts to society through corporate contribution committees staffed by their employees. The classical reason for having a corporate foundation is that a foundation, unlike an in-house committee, can accumulate a reserve fund in the good years to enable it to make gifts in bad years. Several major corporate foundations (many of them in the "smokestack" industries) have been, in effect, consuming their reserves over the past three years. Some of these will likely be forced soon to terminate their grant-making entirely, unless their respective parent companies return to profitability.

There is no ideal or perfect standard for measuring the appropriate size for the reserve fund of a corporate foundation. At General Mills our management has set a policy of trying to have the total assets of our foundation, (i.e., the reserve fund, plus this year's grant from the parent company) on hand at the beginning of the fiscal year, equal to twice the amount budgeted for grant-making in that year. Hence, in theory, we could maintain our level of grant-making through one full year without any infusion of money from our parent company.

It is difficult to generalize about how corporate foundations invest their reserve fund. At General Mills, our reserve fund is invested in fixed income and equity investments and is managed by the same company that manages our corporate pension fund.

I have been active as the manager of three different foundations since October of 1974. In four of these years I was the executive director of the Minneapolis (Community) Foundation. From 1978 to 1980 I was the chief program officer for a private family foundation (General Service Foundation, St. Paul); and since August, 1980, I have been the chief executive of the General Mills (Corporate) Foundation. To my knowledge I am the only foundation executive who has been responsible for administering a corporate, a family and a community foundation since the passage of the TRA 69. I cite this bit of personal history not to try to impress you but to use it as the premise for my personal opinion that the Tax Reform Act of 1969 is a good and timely piece of legislation. Compliance with it has demonstrably strengthened philanthropy in this country. Please note that this is a personal opinion. There are undoubtedly many knowledgeable persons who, for varying reasons, would disagree with my favorable view of this act.

Having said this, let me also state for the record that I believe some refinements can still be made in this act. One of these is in the delicate area of excess business holdings. As you know, there are at present some private foundations which have not yet divested themselves of what the TRA 69 calls "excess business holdings." The vast majority of private foundations have complied with the demands of the TRA 69 regarding excess business holdings.

It would, however, be my opinion, as a citizen and as a lawyer, that the private foundations seeking relief from Congress concerning divestiture of their excess business holdings would be treated with equity, and that any decisions responding to their petition would be predicated, in equity, on the individual merits of each foundation's particular situation.

Regarding the subject of expenditure responsibility, my experience leads me to believe that the strictness of the present rule does no injury to donor foundations but does do injury to smaller and recently established donee organizations who are at present denied support by foundations unwilling to accept expenditure responsibility, even though these same foundations would support such donee organizations if grants to them did not obligate the foundation to exercise expenditure responsibility. It would be my recommendation, in view of current urgent need for support of the non-profit sector, that the Congress ease up on the strictness of the current rule demanding expenditure responsibility for grants to small and recently established but promising health care, educational, cultural, and social service agencies.

Apropos the excise tax levied on foundations by the TRA 69, the Congress has already wisely decreased the level of this tax from 4 percent to 2 percent. However, the Internal Revenue Service now collects from this tax considerably more money than is needed to oversee compliance with the Tax Act of 1969. Hence, prudent tax policy would seem to dictate that this tax be reduced to whatever level is needed to pay for the cost of the IRS Oversight of Compliance with the TRA 69.

In my opinion, the foundations of this country have complied fully with the rules set forth in TRA 69. The abuses addressed by the TRA 69 have, in my view, been eliminated. I am not aware of any manipulative use of the rules of TRA 69 by any foundations, private or public.

In conclusion, I wish to express my appreciation to this committee and its chairman for their courtesy in inviting me to participate in this hearing. I hope that my remarks here will be of some assistance to you and to the Congress in your continuing effort to oversee and guide our national philanthropic process for the common good in our highly favored nation.

Chairman RANGEL. Mr. Martin.

Mr. MARTIN. Thank you, Mr. Chairman.

I appreciate being recognized for the privilege of introducing to the subcommittee a long-time friend and colleague, fraternity brother Bill Bondurant, who is here as the executive director of the Babcock Foundation, one of the large and diverse groups of what may be called middle-size foundations.

He has served on the board of the council on foundations and presently is in that capacity also. He will describe to the subcommittee the array of programs which his foundation is involved in and also the impact of some of the features and changes in the tax code on his foundation.

I am very pleased to welcome him to the subcommittee.

STATEMENT OF WILLIAM L. BONDURANT, EXECUTIVE DIRECTOR, MARY REYNOLDS BABCOCK FOUNDATION, INC.

Mr. BONDURANT. Thank you, Mr. Martin.

Mr. Chairman, I have submitted written testimony that I would like to request be made part of the record and I wish to summarize that if I may.

Chairman RANGEL. Without objection.

Mr. BONDURANT. The Mary Reynolds Babcock Foundation was created 30 years ago after the death of Mary Reynolds Babcock, who struggled, as she wrote briefly before her death, with the issue of longevity of the foundation, and the need to use the remarkable resources that she had inherited to meet human needs in the years to come.

She knew she herself did not have the means to decide in future years what these funds should be addressed to and so she created a private foundation with broadest latitude given the trustees to address human needs as they were to occur in years to come, much as I think as Mr. Rockefeller and others had done in previous years.

She established the foundation with about $12 million, subsequently $3 million more was added to the corpus and that was the initial corpus of the foundation.

There is a little success story that follows: The $15 million initial capitalization has enabled the foundation over the last 30 years to grant in excess of $48 million and we are presently worth $40 million. Every one of the grants has gone to tax-exempt nonprofit organizations or instruments of Government. I am happy to say that the potential for this foundation to continue making grants in a number of charitable and educational areas will continue.

One footnote to that. It was part of her consideration at the time the foundation was set up to give the entire $12 million or $13 million to a university located in the community, she chose not to do that, however, and instead of putting the entire corpus with one particular institution she created a foundation. That university now has received over $13 million or $14 million in the insuing 30 years. In the meantime other institutions have received $34 million and the foundation is currently worth $40 million.

In many years before and since the 1969 act, the foundation has granted in excess of income, especially in years of portfolio growth in market value. We granted $2.7 million last year in excess of 8 percent of our market value. Under this year's regulations we are permitted to fall back to the 5-percent level but the Board chose to exceed that by continuing to pay out over income. It would not surprise me at all if they dipped into the principal from time to time. Partly because we are responding to some economic conditions in the country now in various ways, the cutbacks of Federal dollars have impacted our applications and our program interests and I give examples in my testimony.

For example, we have assisted the North Carolina Coalition on Black Grants, which is seeking ways to allow the public to understand the block grant program and to deal with the State agencies to obtain these funds. Other grants have gone to help nonprofit institutions broaden their public base of support for their programs.

In other cases we made grants to organizations that were not popular enough to receive grants or dollars from the Federal or State tax sources, or from individuals. For example, in the early days the Carolina Brown Lung Association in North Carolina was an organization not very popular and yet had a job to do championing the needs of textile workers. We assisted in getting their case stated in such a way they could be heard.

Other grants have helped establish the hospice program in North Carolina, providing support for victims of Alzheimer's disease and other cases. There is no doubt the Federal cutbacks caused an increase in the applications coming to the foundation. I think at the same time it has caused us to heighten sensitivity to needs of people and try to spread our dollars further and more wisely.

There are a number of grants that have gone to local community organizing and grassroots programs around the south and the Nation in areas such as teenage pregnancy, nontraditional jobs for women, hazardous waste removal and more recently we have worked in the area of worker-ownership where businesses have been closing for economic reasons.

Our grants run $30,000 average and that puts us close to the grassroots. A grant in that amount provides on the average the salary for someone, a desk and telephone. It is amazing how much good someone can do with a desk and telephone in this world.

Three points and I will close. First, I think foundations provide an extremely critical and precious resource to deal with human needs as they change over the long term. Many of us as private citizens or Government officials must deal with the compelling issues of the day responding to pressures and needs felt today. The foundations, however, if established with the broad latitude to meet changing needs have the resources to anticipate and move quickly into evolving needs in the public which have not yet been addressed by other sources, public or private.

The crisis in 1967 and 1968 in drug abuse among young people I think is a good example of this. It is a case where foundations moved in quickly because it was not yet in the public domain for tax dollars.

I think it is in the Government's interest to keep this resource very much alive.

My second point is the private foundations provide a healthy option for individuals during life or at death to return to their communities the wealth which they have amassed during their lifetime.

Often the individual with such resources does not want to leave them all to their children, or to an institution that might change over time or whose need for existence may change, or to the Government. The foundation provides a way for those funds to be set aside in perpetuity for the public good and administered to meet changing needs within guidelines established by the donor and under the existing board of trustees.

Third, foundations bring out the very best in people both donors and donees. When we address needs of other people, we do the best service for them and for ourselves. Each year the Babcock Foundation receives thousands of requests from people who, dreaming of a better world, submit their hopes for a few dollars to address the problem they are deeply concerned about. We cannot meet all requests but the fact that foundations exist to encourage and provide incentives for people to focus on the needs of others, will prove to be a vital asset in our society. There will always be more needs than resources to meet them in our society but foundations with limited dollars can and will choose among the needs and develop over a period of time with staff experience some continuity and ability to meet the needs.

The foundations therefore contribute to the diversity that we cherish in this country.

Thank you very much.

[The prepared statement follows:]

STATEMENT OF WILLIAM L. BONDURANT, EXECUTIVE DIRECTOR, MARY REYNOLDS BABCOCK FOUNDATION

I am William Bondurant, Executive Director of the Mary Reynolds Babcock Foundation located in Winston-Salem, North Carolina. I am on the board of the Council on Foundations, and recently served two years as chairman of the board of the Southeastern Council of Foundations. I have been associated with the Mary Reynolds Babcock Foundation for fifteen years, during which time I took a two-year leave of absence to head the North Carolina Department of Administration under Governor James Holshouser.

The Mary Reynolds Babcock Foundation was created thirty years ago with a bequest of $12 million from Mrs. Babcock's estate. During her last illness she wrote from the hospital:

"I somehow thought I'd live forever due to the good health I've enjoyed in my past life. I wanted to leave the fortune my father & mother left me to do the good things they would have done had they lived longer. During my life time I have tried to use it wisely in benefitting others and with discrimination in my own use of it. . . . I am setting apart an amount for my husband and my children to sift and find the wisest use for it. Due to these changing times I do not want to tie it up directly for any special cause."

The foundation was established with the broad guidelines, "to improve the human condition the world over." Additional resources of around $3 million came into the foundation in the early years with the result that the foundation was "capitalized" at around $15 million.

Thus we fall into that large and diverse group of "middle size" foundations in America, too small to make a major dent in our nation's problems but large enough to think that we ought to try!

Here are some figures that we are pleased with: over the past thirty years the yield on our $15 million initial endowment has enabled us to make grants and program-related investments totalling in excess of $48 million, while at the same time the foundation's assets have grown to a value of $40 million. We started with $15 million, we have granted $48 million, and we are currently worth $40 million.

Before the foundation was created the donor considered simply giving the assets to a local university enlarging that university's resources by $12 or 13 million. Instead, however, she chose to create the foundation, and it is interesting to note that that university has now received over $14 million from the foundation, while other beneficiaries have received an additional $34 million. And we continue to be in a position to help not only that university but many other non-proft organizations around the country.

In many years both before and since the Tax Reform Act, our grants exceeded our income, especially during years of growth in our portfolio market value.

Last year we paid out over $2.7 million which was over 8% of our market value. Under this year's new regulations, we are permitted to fall back to the 5 percent requirement, but the board has chosen instead to continue to pay out all of our income, and it would not surprise me at all if they were to continue to dip into principal from time to time.

We have responded in several ways to the cutbacks of federal dollars in domestic programs within our areas of interest. We have, for example, assisted a group in eastern North Carolina, the N.C. Coalition on Block Grants, which is interested in monitoring the administration of the block grant program through the state agencies, with particular attention to the needs of the state's poorest and hungriest citizens. Other grants have gone to help non-profit institutions develop their fundraising capability so as to improve their self-sufficiency through broader bases of public support. We are confident that some of our grants have gone to organizations which, but for the private foundation dollars, would not exist because they could not get dollars from other sources for reasons of popularity or public sensitivity. For example, in its early days the Carolina Brown Lung Association was not a very well-known or popular organization in our state. The association needed money to better state their case before the public and, ultimately, before the Supreme Court, and our dollars helped them establish their case and their credibility so as to be able to champion the cause of afflicted textile workers. Other grants helped establish Hospice and a network of support groups for Alzheimers disease victims in North Carolina.

There is no doubt that the federal cutbacks have caused an increase in the number of compelling proposals dealing with human need at the local, community level. Thus a number of recent grants have gone toward local community organizing around issues of hazardous waste disposal, problems of teenage pregnancy, non-traditional jobs for women and the development of worker-ownership where local businesses are closing down. Our grants, averaging around $30,000, generally pay for a salary or two, a desk or two, and a telephone in the office of a small non-profit organization. It is amazing how much one person can do with a good cause, a small foundation grant, and a telephone!

Now three brief points and I will close.

First, foundations provide an extremely critical, and precious, resource to deal with human needs as they change over the long term. Many of us as private citizens or as government officials must necessarily deal with compelling issues of the day, responding very much to the pressures and the needs felt at this moment. Foundations, however, if established with broad latitude to meet changing human needs, have the resources to anticipate and move quickly into evolving areas of public need which have not yet been addressed by either the government or by private citizens. For example, I think of the drug crisis that hit this country in 1967–68, when private foundations were about the only source of revenue for many local community groups suddenly confronted with drug abuse among their teenage populations. As the government became more active in dealing with the drug crisis, the private foundations were able to move to other human needs. The responsiveness and flexibility of foundations were critical in many communities. It is in the government's interest to keep this resource alive!

My second point is that private foundations provide a healthy option for individuals, during life or at death, to return to their communities the wealth which they have amassed during their lifetime. Often the individual with such resources does not want to leave all of their wealth to their children, to specific institutions or agencies which may change in time or whose need for existence may change, or to the government. The foundation provides a way for their funds to be set aside in perperuity for the public good, and administered to meet changing needs within the guidelines established by the donor and under the good judgment of the current board of directors of the foundation.

Third, foundations bring out the best in people, both donors and donees. Each year we receive thousands of requests from people who, dreaming of a better world, submit to us their hopes for a few dollars to address a problem which they feel deeply about. Unhappily we cannot meet all of those requests, but the very fact that we exist and others do to encourage that human desire for a better world is absolutely vital to our society. There will always be more needs than there are resources to meet them, and the foundations, with their limited dollars, must choose among the innumerable needs just as you must choose here in Congress among the many needs facing the federal government. We have all long believed in this country that diversity is an asset and that many of our problems are best solved by a variety of individuals and institutions working on the solutions. Foundations encourage that diversity.

Chairman RANGEL. Ms. Allen, please.

STATEMENT OF MARJORIE POWELL ALLEN, PRESIDENT, THE POWELL FAMILY FOUNDATION

Ms. ALLEN. Thank you.

I am Marjorie Powell Allen, president of the Powell Family Foundation. We are a small family foundation in the Greater Kansas City area. Our assets are approximately $25 million, a substantial portion of which consists of ownership in a publicly held corporation of which the family and the foundation own approximately 21 percent.

I am pleased to be here today to speak enthusiastically about the role that the small foundation can play in being sensitive to and meeting changing community needs. Many times the actions and initiatives of the private foundations are responsible for stimulating greater increased giving by other foundations and individuals. I would be happy to give examples of that if you would like.

Our particular board is made up of family members. They attend quarterly meetings—we have almost a perfect attendance. They are not compensated for their efforts, and over the years—in which we have become I believe more professional—they have taken a very strong and conscientious interest in what the foundation is doing.

I would suggest to the committee that the reporting and recordkeeping requirements of the Tax Reform Act are burdensome to a small foundation.

The expenditure responsibilities are so great that we are one of many foundations who do not make grants except to public charities. This of course greatly limits the ability of the private foundation to assist in new programs. I will tell you that we made one exception this year with a program related investment as we combined with other foundations to help in the construction of a new downtown hotel. Because a group of us banded together we felt that we could meet the legal requirements.

Another example, not a month old, is that our foundation was interested in making a grant to three churches to establish a day camp for underprivileged youth. This was eventually done but with great difficulty because they did not have the proper exemption letter from the Internal Revenue Service. I therefore strongly endorse the provision of the present bill which exempts grants of $15,000 or less from the expenditure responsibility requirements.

Most small private foundations as you know were started by founders of businesses who wanted to see the proceeds from their efforts used for philanthropy. The requirement of divestiture of excess business holdings is severe and certainly limited creation of private foundations. I would also endorse the proposed extension of the time for divestiture.

There were questions asked yesterday about public accessibility and I would like to make some comments that I think are typical of foundations in my area. We will make an appointment with anyone who has a legitimate request to see us.

Another development since 1969 which has been of great benefit to small private foundations is the creation of regional associations. In the Greater Kansas City area, a group of 37 private foundations formed what we call the Clearinghouse for Midcontinent Foundations. This group has led to an exchange of information among its members and a pooling of efforts to provide surveys of needs in the Kansas City area.

As a result of this cooperation, there have been more joint grants made in the last 5 years than ever made previously. An example is a recent coalition of eight foundations and the Robert Wood Johnson Foundation to establish health care centers for the elderly and for teenagers. These centers are proving very successful and provide health care to a segment that would not have received it otherwise.

In conclusion, Mr. Chairman, I realize that there are problems that are part of the foundation community, but in Kansas City in recent years we have become more open, more visible, and invite the view of grassroots representatives and are gradually including more women and minorities. I truly hope the committee will encourage foundations to be with us on a permanent basis, to correct abuses where they occur, and to appreciate the ability that we have to move quickly and effectively to meet community needs.

Thank you.

[The prepared statement follows:]

STATEMENT OF MARJORIE P. ALLEN, PRESIDENT, THE POWELL FAMILY FOUNDATION

I am Marjorie Powell Allen, president of the Powell Family Foundation. The address of the Foundation is 10990 Roe Avenue, P.O. Box 7270, Shawnee Mission, Kansas 66207, which is in the Greater Kansas City area. I am also a member of the Board of the Council on Foundations, as well as other charitable organizations. The Powell Family Foundation is a relatively small foundation founded by my father, the late George E. Powell. It has assets of approximately $25,000,000, a substantial portion of which consists of Yellow Freight Systems, Inc. stock, a publicly-held corporation of which the Powell Family and the Powell Family Foundation own approximately 21 percent. The Committee has received testimony from other witnesses furnishing it with national statistics concerning private foundations, and I do not intend to burden it with a repetition of that material. I would like to express to the Committee my concerns as a president of a small private foundation in the Midwest.

Private foundations have played a material role in the fabric of philanthropy throughout the history of the United States. They have supported health care, medical research, education, social services, the arts and a great many other charitable programs. The small foundations are close to the communities in which they are located and are able to respond quickly to community needs. Many times the actions and initiatives of the private foundations are responsible for stimulating greatly increased giving by other foundations and individuals. The Tax Reform Act of

1969 had a very adverse effect upon the vitality and growth of private foundations. There has been a decline in the number of new private foundations formed and many private foundations which were in existence in 1969 have been liquidated since then. I believe the reasons for the decline are many. Included among them are the following:

1. Excess reporting and record keeping requirements
2. Expenditure responsibility requirements
3. Divestiture of excess business holdings
4. Severe penalties automatically imposed even when the violation was in good faith
5. The less favorable treatment for income tax purposes of gifts to private foundations.

The reporting and record keeping requirements of the Tax Reform Act of 1969 and the regulations issued thereunder are onerous when imposed upon a small foundation that does not have a large staff to keep abreast of the regulations and insure compliance with them. Likewise the expenditure responsibility requirements are so great that the small foundation simply lacks the staff to meet the requirements and many of them simply do not make grants except to public charities. This, of course, greatly limits the ability of the private foundation to assist in new and innovative programs that might very well be of tremendous long-term benefit to society. We have made one exception with a Program Related Investment to assist in the construction of our new downtown hotel, as several foundations banded together to both make the loan and accept expenditure responsibility for the project.

In another example, our foundation was interested in making a grant to three churches to establish a day camp center for underprivileged youth, and had great difficulty because they did not have the proper exemption letter from the Internal Revenue Service.

I strongly endorse the provisions of bill H.R. 3043, which exempts grants of $15,000 or less from the expenditure responsibility requirements. This low limit would certainly prevent abuse, but would greatly expand the fields in which the private foundations could move. I also support the establishment by the Internal Revenue Service of the Form 990 Advisory Committee which is evaluating revisions to Form 990 and hope that those revisions will simplify and reduce the reporting and accounting provisions for the smaller foundations.

Most small private foundations are started by the founders of businesses who want to see the proceeds of their efforts used for philanthropy. The requirement of divestiture of excess business holdings is extremely severe and has certainly limited the creation of private foundations. I strongly endorse the proposed extension of time for divestiture, and in addition, would urge that the committee give consideration to some other means of preventing abuses other than the purely mechanical test of percentage of stock ownership.

The present law provides very severe penalties automatically for all violations of private foundations rules. The rules are complicated and quite often a foundation manager of a small foundation does not have the expertise or the staff to fully interpret them so that violations are often in good faith and can be corrected. I strongly support the provisions of H.R. 3043 which would give the Secretary of the Treasury authority to abate the first level penalty in cases where he deems that the violation was in good faith and was corrected within a specified period.

There has been a development since 1969 in the philanthropic field which has been of great benefit to the small private foundations in the creation of regional associations. In the Greater Kansas City area a group of 37 private foundations, most of which are not large, formed the Clearinghouse for Midcontinent Foundations. This group has lead to an exchange of information among its member foundations and a pooling of efforts to provide surveys of the needs in the Kansas City area. As a result of this cooperation, there have been more joint grants made in the last five years by the member foundations than were ever made previously. An example is a recent coalition of eight local foundations and the Robert Woods Johnson Foundation to establish two health care centers, one for the elderly and one for teenagers. These centers have been very successful and are providing health care to a segment of the population which was not receiving health care. It is provided before the patient becomes ill and has to be admitted to a hospital, thus reducing the cost of health care. The coalition is presently contemplating establishing other health care centers in the Kansas City area. These centers would never have been established had not there been a cooperative effort by local foundations which arose under the sponsorship of the Clearinghouse. The establishment of regional association should be encouraged.

I would urge the committee to not only consider some of the problems that my colleagues on the panel have discussed in connection with their large foundations, but also the problems which exist for the small private foundation which serves many small communities and which in the aggregate accomplishes a great deal to benefit the communities in which they are located.

Chairman RANGEL. Thank you very much, Ms. Allen.

Those two bells mean we have a vote on the House floor. Would any of the panelists have a problem if we suspend until 12:30 in order to ask questions?

Are there any problems with members of the subcommittee?

The subcommittee will recess, then, until 12:30 to give us time to vote and come back.

[Recess.]

Chairman RANGEL. The subcommittee will resume the hearings. I thank the panel for their patience.

Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman. I have a few questions. I want to thank the panel. They were very, very good.

I would like to ask Mr. Rogers or anyone to respond. What are your thoughts regarding allegations that the administrative expenses, particularly trustee expenses, are exorbitant? Is that the rule or is that the exception?

Dr. ROGERS. I think it is an exception, but I am deeply concerned about it, Mr. Duncan. Though we are in the private sector we have very real public responsibilities and I am troubled and embarrassed if trustees are overcompensated. I would point out that the law already in effect, if implemented, there are means for dealing with that.

Mr. DUNCAN. Do any other people care to comment?

Mr. SHANNON. I share the statement of Dr. Rogers. If there is demonstrably excessive compensation for trustees now that is contrary to the current statute and there is machinery to deal with that.

But clearly on the basis of the statistics garnered by the Council on Foundations, the typical foundation does not grant such compensation and where there is compensation it is very modest.

Ms. ALLEN. I would endorse the fact that no compensation is typical. I serve on three boards and none of them give compensation of any kind.

Mr. DUNCAN. Do you gentlemen agree?

Mr. HEYNS. Yes, I do.

Mr. BONDURANT. Yes, I do.

Mr. DUNCAN. Thank you, Mr. Chairman.

Chairman RANGEL. Mr. Thomas.

Mr. THOMAS. Thank you, Mr. Chairman.

This is the first opportunity we have had to address the folks we are supposed to be looking at. I am impressed by the broad-based nature of the panel. At one end of the panel we have a foundation giving away by law more than the foundation at the other end has in total assets.

Some of you may have heard comments yesterday by our initial panelists so if you did hear them you will understand why I ask these questions. If you didn't, you will soon catch on.

I would like each of you to respond briefly. No. 1, do you have a listed phone number?

Mr. **Heyns**. Yes.

Mr. **Bondurant**. Yes.

Dr. **Rogers**. Yes.

Mr. **Shannon**. Yes.

Ms. **Allen**. Yes.

Mr. **Thomas**. Do you publish an annual report?

Mr. **Heyns**. Yes.

Mr. **Bondurant**. Yes.

Dr. **Rogers**. Yes.

Mr. **Shannon**. Yes.

Ms. **Allen**. Yes.

Mr. **Thomas**. In the report is there information about the board so that someone looking could understand who they were and the type of person they were either in terms of their business holdings or racial background?

Mr. **Heyns**. I will have to look at the annual report.

Mr. **Thomas**. Or is the information readily available?

Mr. **Heyns**. The names are all listed. I am not sure if the affiliation is listed.

Dr. **Rogers**. I think the answer is "yes" for all of us, Mr. Thomas, though I think you also had a subset to your question of racial background there and the answer is no to that.

Mr. **Thomas**. Are there photographs, for example, in the annual report, that would be of some assistance? In other words, you are not like some of those foundations that are hard to find.

You indicated that you would meet with anyone, Ms. Allen, who was bona fide in terms of their request for funds.

There are a group of people out there who are more or less sophisticated about the granting program. Do you have any means of sharing information between each other?

Mr. Bondurant, in your statement you say the foundations bring out the best in people, both donors and donees. Each year we receive thousands of requests from people who dream of a better world—that is the high side of foundations. We are dealing with the human element and to a degree I wonder if you have any kind of communication procedures to identify those folks who work the scene. Do any of you have any downside experiences of people who took you for money who were bummers in terms of investments? If so, is there any way to communicate with other foundations to be on the lookout for these people who, on the surface, appear to be good and worthy but actually don't live up to what they said they were going to do with the money? What procedures do you have either to communicate that or make sure you don't have that many bummers?

Mr. **Heyns**. Mr. Chairman, that is actually a complicated question. I don't think any of us is interested in the development of a black list and it may well be that some of our grants, and indeed it has been the case with us, that some grants have not worked out in the way intended. There was a change in leadership or it was a fragile organization and did not successfully handle the first couple years.

I think we do exchange information but I think we do it with a good deal of circumspection in the sense we don't want to unduly jeopardize their opportunities to get grants from other sources.

However, I think a real thief will get pretty well identified and information about the case will be pretty well circulated.

Mr. **Thomas**. Is there more of that going on, in terms of exchanging information, about the kinds of grants you give and to whom?

Mr. **Heyns**. There certainly is. I would like to pay tribute to the regional organizations, the San Francisco, northern California grantmakers, for example, and other groups Ms. Allen referred to. These people have been effective in improving communications both ways. The problem you refer to is one area. The need to help the needy organizations that cannot cope with the complexities of fundraising. The other is the importance of calibrating with others when we alone cannot satisfy their needs.

Dr. **Rogers**. There is a flip side to your question, too, Mr. Thomas. I agree, I think communication among foundations is vastly greater than in times past in terms of things to share opportunities in various regions of the country. I think one of the things that is of a concern to thoughtful foundation managers is how you let the little guy know that you are available as a source of funds, the major universities, major hospitals and so on know exactly how to get at foundations while others don't.

So I think a number of foundations and certainly including ours are trying some creative ways of broadly advertising that moneys would be available for programs in a certain area to try and encourage people who may not have ever thought of a foundation as a potential source of funding to try their luck at that.

Mr. **Thomas**. That is true for the larger foundations who have vast sums and are interested in giving for specific purposes such as yours or just generally. But one of the things I think we have to remember, and I think Ms. Allen would be a good example of that, is there are some people who are more or less community oriented. Given the limited resources they have, their interest is in putting them back to work in their community.

Is that true or would you be interested in trying to examine requests from all over the United States with the limited funds you have? Or do you feel you are primarily oriented toward Kansas City?

Ms. **Allen**. We get requests from all over the United States. We have to be visible from the amount of mail we receive.

Second, most of our efforts are in Kansas City. One technique we use because we are small and we represent others that are about our size, and I give you an example, we have a City Union Mission doing an important task. No visibility in the community. We help them gather together representatives of small foundations to come to that organization and have a meeting just to share information. The organization itself shared the information. We helped convene the group. So this might be an example of where we could use our position to help get people to the point that they can decide for themselves which would be what really like to do.

Mr. **Shannon**. If I might comment on that, Mr. Thomas, you will recall that when the Filer Commission made its report in 1975 one of the recommendations was that foundations have open meetings.

With considerable misgiving the Minnesota Counsel on Foundations which now has about 117 members, decided then that they would embark on this policy of having an open meeting annually, really wide open to try to create a public forum for donors and donees to come together to talk about problems of the common good.

That program has been very successful so that now we have two open meetings a year, one in the Twin Cities and one out of State typically in one of the community college campuses. If you would look at the progress of that program from year to year the donees and the needs of the different areas of health care, of economic development, of most recently food, shelter and clothing, have come to dominate the agenda so that although it was started by the donors it is driven by the donees.

Mr. THOMAS. How successfully have the needs of the donees been met? In opening up the process, do you find the floodgates open and you have so many people who have needs you cannot possibly meet them?

Mr. SHANNON. You do find that the public needs are greater than the private resources but in response to your original question it seems to me this is a forum which is mutually acceptable to the donors and donees for identifying and getting a consensus on both sides of that fence as to what the current urgent needs are and what are the priorities, and I think the system works better. It is more open, it is more responsible in our area.

Mr. THOMAS. Thank you, Mr. Chairman.

My time has expired.

Chairman RANGEL. Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman.

I have one other question I would like to ask.

Do you find that the smaller nongovernment colleges are having more difficulty now than the large colleges and universities?

Mr. HEYNS. I am sorry.

Mr. DUNCAN. We have the situation where small colleges request more, they have more difficulty in continuing operations than in prior years.

Mr. HEYNS. Mr. Duncan, it is clear that the recession and the enrollment problems are enormously increasing the problems of small liberal arts colleges particularly. The competition for support is intense and they are indeed having more trouble.

Mr. DUNCAN. Anyone else?

Ms. ALLEN. I think it is also true that we perhaps have more colleges in this country than our population will justify in time and there will need to be a sorting out. I would like to think that the dollars follow fine programs and in our area where colleges, small ones, have outstanding programs they are getting good support, others are having real difficulty.

Mr. DUNCAN. Thank you.

Chairman RANGEL. Thank you.

I assume that this panel has no problem with the requirement of public reports—all of you are very proud of the work you are doing and of course most of you are very successful. Ms. Allen indicated that she does represent a smaller foundation.

So the question I am asking—I hope you will think in terms of other foundations that we don't want to put an undue burden on—but, notwithstanding the testimony of some of our witnesses, all of you do believe that there is a public responsibility for the work that you do in behalf of charitable functions?

Dr. **Rogers**. Right.

Chairman **Rangel**. Would you agree that there has to be some public reports as to what you are doing other than to IRS? Mr. Thomas asked about telephone numbers.

Basically what we are talking about is that there should be some report to let people know who you are, what you are doing, and what you are trying to do. Is there any problem at all with that as being so burdensome that it is going to affect contributions or creation of foundations?

Mr. **Bondurant**. No problem from our point of view. We found that the more public disclosure is invigorating to the foundation. Several years ago we held a public meeting of our board and we invited the public, including folks we had turned down as well as others, to come to the meeting and to sit and talk with the foundation board about its purposes and programs. And that kind of disclosure we found to be invigorating if anything.

It not only helped us explain why we didn't make grants in certain areas, we didn't have unlimited resources and we couldn't, but we also found applicants, for example the Brown Lung Association that I mentioned, that we would probably not have listened to if we had just seen their application in writing. But they showed up six strong in a purple microbus, I will never forget it, and I am sure we made a grant to them partly because of that public meeting.

It broadened our horizons as well as helped us refine our goals.

Chairman **Rangel**. You have heard testimony concerning the minimum payout. Is there anyone who has any problem in requiring that there should be a minimum amount that is paid out by foundations? Would anyone have a problem?

Dr. **Rogers**. I think I can speak for the group, no one at this table has any problems with the payout as it now stands, Mr. Rangel.

Chairman **Rangel**. I would suspect most of you go beyond the minimum in terms of that.

Mr. **Heyns**. That is correct.

Mr. **Bondurant**. Yes.

Mr. **Shannon**. Yes.

Ms. **Allen**. Yes.

Dr. **Rogers**. I think we all do.

Chairman **Rangel**. I am coming up with the easy ones first.

Now, Ms. Allen, you seem to have a problem with the oversight responsibility. What I don't understand is why would anyone that treasured their good name and reputation of their foundation not want to be responsible or be certain for themselves, much less for the general public, that that money is used for that specific charitable purpose?

Ms. **Allen**. Well, I think it is generally a problem with the small grassroots group just getting started. Again, the 501(c)(3) is about a 6-month process. Many of them don't have that sophistication. So I am really referring to the small group getting started that maybe you can do something to help while they get everything in place.

My example of my three churches was the one. This was a first effort and if they had to make a delay it was not going to happen this summer. So we found another way to legally make it happen.

Chairman RANGEL. I can understand that.

Mr. Rogers, I notice from your brochures that you don't make grants to these type of grassroots, untested organizations; they have to be section 501(c)(3) organizations.

Dr. ROGERS. Yes, in general, that is correct, Mr. Chairman. I am pausing only in that I would say we have funded many what I would like to feel are grassroots early demonstrations, early experiments in how you deliver care to groups who are having a tough time getting it.

Chairman RANGEL. Listen, your reputation precedes you. Everyone knows of the good work the foundation is doing. It is because you are doing so well that we want you to assist us in establishing guidelines for those not as strong and powerful and at the same time encourage this good work.

But are the oversight responsibilities really why you just stick with 501(c)(3)'s?

Dr. ROGERS. No, because we are well staffed. We are comfortable in taking oversight responsibilities. This direct response to your question in terms of how we can help or what our advice would be, my own feeling is that the Conable-Shannon-Gephardt bill does make nice course corrections which would permit, I think, foundations to better fulfill their destiny. I think that would be particularly true for the smaller foundations that have a somewhat tougher time with less staff in dealing with some of the constraints under the current law.

Chairman RANGEL. Charitable organizations normally have—well, they have the legal right to get involved in voter registration. It seems as though some time around 1969 a foundation got involved in voter registration and it was perceived by certain Members of Congress that they were involved in the political campaign so the result was that the legislation that came out restricted foundations, as opposed to community groups, from getting involved in voter registration or education of voters unless it was on a five-State-type basis.

If assurances could be made that the law would be strictly oversighted—that is, that no organization, foundations, charities, could be involved in any partisan campaigns, or get involved in registration of Democrats or Republicans, or get involved with any particular candidacy—do you see any reason why this restriction should be continued to prevent foundations from supporting education as relates to voter registration?

Dr. ROGERS. Would you like to come down the group, Mr. Chairman?

Chairman RANGEL. Ms. Allen.

Ms. ALLEN. Under the conditions as you state them I think we would have an interest in it. As it is now, it just has political overtones and we don't touch it.

Chairman RANGEL. I want to make it clear so that my question is not misunderstood, because this is a very sensitive area, and certainly if there is abuse, it can be all over the lot—right, left, Republicans and Democrats. I appreciate your response. I did mean it strictly as an educational part of community work.

Mr. Shannon.

Mr. SHANNON. I would concur in that opinion. Given restrictions you mentioned, it would be bipartisan, I see no problem with it. At the present time we do support ventures like that which are within the law and I think if the law were liberalized we would gladly welcome the opportunity to broaden the franchise to participate in the political process. We ought to, I think.

Chairman RANGEL. Dr. Rogers.

Dr. ROGERS. I see no problems with it as you stated it.

Mr. BONDURANT. Mr. Chairman, at the risk of a platitude, I think the only thing wrong with democracy is there isn't enough of it. I would say the foundation supported voter education in the 1960's and we would continue it under the terms you gave certainly and we have done this for a number of years. So I see no likelihood we would change that.

Chairman RANGEL. Mr. Heyns.

Mr. HEYNS. I think there are real benefits to removing the impediment to those grants.

Chairman RANGEL. We have had a pretty informal exchange, Mr. Guarini, from the foundation managers, very successful foundation managers. We have attempted to make inquiries of them as to how to improve the law to expand foundations and to make more donations to them but at the same time for them to recognize that there are some foundations such as the one that Ms. Allen represents that just don't have the staff or wherewithal to do the things they do so well.

I say that in prefacing your recognition.

Mr. GUARINI. Thank you, Mr. Chairman.

I wonder whether the question of administration expenses has been gone into by the managers. You are the ones administering the funds. Have you found that the expenditures in your individual cases of running a foundation are inordinate or higher than anticipated or than what should be expected?

Dr. ROGERS. I think most of us, Mr. Chairman, Mr. Guarini, pay very careful attention to just what fraction of our grantmaking that represents. Again, I think all of us have the feeling that they should remain—we should remain tight, lean, and that administrative decisions for giving away or for making grants should be minimal. I think most foundations look very carefully at that and try to keep that on the low side.

There are obviously some exceptions but I think they are rare.

Mr. GUARINI. How do you think we should handle the exceptions? Have continuous oversight? Or do you think the rules should be changed so there would be a restriction placed upon the amount of administrative expenses permitted?

Should there be a rule of thumb or legislative rule?

Mr. HEYNS. Could I volunteer, I would think it very difficult to arrive at a formula. I think it is important that there be vigilence about the matter but a strict percentage, for example, would be a very difficult problem. Let me observe, for example, that in an area where relatively small amounts of money might actually be expended, but the number of applicants is very large, it takes every bit as much staff work to intelligently make a decision and recommendation about a small grant as for as a large one.

So if a foundation has as its clientele quite a number of recipients receiving small amounts of money that staff could be considerable; whereas the same amount spent in a single program where the applicants are fairly well known and well established, that might take a very small staff.

Mr. GUARINI. That is the good side. I grant you that.

Looking at the other side how do we prevent abuses in case there are excesses where the people are not well motivated?

Ms. ALLEN. I would like to call your attention to the fact there is a survey done by the Council of Foundations on a regular basis which indicates how much it is costing to run various foundations.

On the three boards on which I am active we look at that every time it comes out to see where we fall within the guidelines. I would think an oversight committee or an individual conversant in the field would see the red flags and could deal with that on an individual basis because if you are in the scholarship programs it takes one kind of staff, you know, so much depends on what you are doing and what you ought to be spending to do it.

Mr. GUARINI. You don't see a way to implement a meaningful law without hurting the people who are trying to truly administer a good program?

Ms. ALLEN. I have a little problem with it because in Kansas City I simply don't see any abuses. I indeed see people that need encouragement because they are working hard at it. I am confident there must be a case or two around the country and that needs to be dealt with. I would hope it would not require a law.

Mr. THOMAS. Would the gentleman yield?

Mr. GUARINI. Yes.

Mr. THOMAS. Yesterday in the panel of attorneys general from Illinois, New York, and California, there were examples given of where it was—it was in California—where the trustees' fees were considered excessive by the State of California. They were challenged in court, and the judge made a decision as to what was an appropriate percentage given the risk involved and the size of the foundation and so on. It just seemed to me that given the relationship and the very common ground between State law and Federal law that that sounded like a good way to resolve it.

Where there are situations where perhaps there is a question about remuneration it could be challenged on a case-by-case basis. I was thinking of a general percentage along the lines of the gentleman's question and as I started talking to various foundations they started pointing out to me again how diverse the foundations are. What would clearly be exhorbitant in one area based on administration, in another it would not.

Mr. GUARINI. Who would be the moving party in the California case?

Mr. THOMAS. I say California on behalf of the State, and for charity in which the way the charity operates was the way the particular case was handled. I assume it would be the attorneys general.

Mr. GUARINI. Under the Federal law the system is wide open now.

Mr. THOMAS. Yes. I am trying to find out the degree to which there would be a problem which would necessitate moving at the Federal law. Just for the gentleman's benefit, in talking to a number of foundations I have come to the basic conclusion that these people have presented. We can continue to investigate it because I am concerned about that. I just think that as is oftentimes the case, the remedy will probably be a lot worse than the problem. That is what we discussed with the attorneys general and they have dealt with specific instances of that.

Dr. ROGERS. Could I interject, Mr. Thomas. It seems to my judgment the present law which prohibits self-dealing and prohibits excessive trustee compensation and so on, if actively enforced I think the law is already there to try and deal with the problem, Mr. Guarini.

Mr. GUARINI. Loading family onto the payroll is another question, too.

Dr. ROGERS. Under the self-dealing provisions I think you will find the mechanisms are already there to deal with that.

Mr. GUARINI. Thank you.

Chairman RANGEL. If there are no other questions, I want to thank this panel. We will leave the record open so that members that have other questions to ask can ask you.

By the same token, there may be recommendations that you have, or questions that were not asked of you. I think you get the thrust of our oversight responsibility. We want to improve where we can, and, if it is not broken, we don't want to fix it. But we do need honest disclosure of some of these things, and so we will be relying on the Council and the foundations to assist us in this effort. It will be up to us to be certain that we don't overburden the smaller foundations that want to do charitable work.

In behalf of the subcommittee, I thank you for your contribution and we will leave the record open for further questions.

[The following was subsequently received:]

THE ROBERT WOOD JOHNSON FOUNDATION,
Princeton, N.J., July 19, 1983.

JOHN J. SALMON, Esq.,
Chief Counsel, Committee on Ways and Means,
Washington, D.C.

DEAR MR. SALMON: During the recent hearings conducted by the Subcommittee on Oversight of the Committee on Ways and Means, Chairman Rangel indicated that the Record of these hearings would remain open to receive further recommendations concerning those matters before the Subcommittee. It is in response to such request for additional assistance that we submit this further statement and request that it be made a part of the record of the hearings.

In light of the hearings there are three major areas of private foundation regulation which we would emphasize as deserving the Subcommittee's careful consideration as it proceeds with its deliberations. These are:

1. H.R. 3043, designed to alleviate certain burdensome and unnecessary restrictions imposed on private foundations in 1969;
2. The retention of the basic framework of section 4943 of the Internal Revenue Code, which restricts private foundation holdings in business enterprises; and
3. The measures currently in existence which have been taken to provide the public information about and access to private foundations.

H.R. 3043

The private foundation rules adopted by Congress in 1979 have provided an effective overall regulatory framework, and foundations generally have complied with these rules. This was the near unanimous opinion of the witnesses appearing before the Subcommittee. There are, however, certain significant impediments to private foundation activity which can be eliminated without harming the basic regulatory system. The provisions of H.R. 3043 would remove five of these impediments. We wholeheartedly endorse this legislation and urge its adoption as a way of encouraging growth of foundations and assisting in their accomplishment of charitable objections.

EXCESS BUSINESS HOLDINGS

During the hearings, the Subcommittee was presented with testimony urging repeal of the excess business holdings rules. For the reasons stated below, it is our strong recommendation that Congress not repeal nor substantially alter these excess business holdings rules.

The excess business holdings rules were imposed by Congress in 1969 because it found that a significant number of foundations were deeply involved in the active conduct of business enterprises. The rules imposing restrictions on the business holdings of private foundations are an integral part of the method chosen by Congress to ensure the proper functioning of foundations. Since the adoption of these limitations, most foundations with potential business holdings have fully complied with the requirements, through sales, exchanges, or gifts. Because compliance has thus been able to be achieved, no fundamental revisions of the excess business holdings rules are needed.

There is one aspect of the rules which does appear to merit modification: the separate, five-year divestiture requirement for newly-acquired excess holdings. This requirement might well result in unfavorable forced sales, and reasonable extension of the divestiture period appears to be entirely appropriate.

PUBLIC INFORMATION ON PRIVATE FOUNDATIONS

Sincere concerns were expressed throughout the hearings about the adequacy of public information on and access to private foundations. While every diligent foundation manager feels more can always be done in this area, it would be a mistake to overlook the measures already in existence to ensure such public availability and accountability. These measures include the annual filing of Form 990 PF required by the Internal Revenue Code and the publications and facilities provided to the public by the Foundation Center.

FORM 990 PF

Annually each private foundation must file a tax return on Form 990 PF with the Internal Revenue Service covering its grant and financial activities during the tax year. This return is available for public inspection; and each foundation is required to publish notice of such availability and to provide copies of it to all who request it. In addition, the Foundation Center (an independent organization substantially funded by private foundations) maintains microfiche files of these Forms 990 PF for public use in the 134 nationwide location which it operates or which receive materials from it through its cooperating collections program.

FOUNDATION CENTER

The Foundation Center is a unique source of broad and comprehensive information on private foundations available for free public use. The Center has four reference libraries which are operated directly by the Center. These are located in New York City, Washington, D.C., Cleveland, and San Francisco. In addition, the Center provides foundation reference materials to libraries and other similar facilities in at least one location in each state and in Puerto Rico and the Virgin Islands. Further, the Foundation Center maintains a toll-free telephone number (800-424-9836) to provide assistance to those seeking information on private foundations. The Foundation Center also publishes a number of books and other materials to assist grantseekers.

Sincerely yours,

David E. Rogers, M.D.

Chairman Rangel. We will now hear from the grantees, Christopher Edley, president of the United Negro College Fund; Pablo Eisenberg, president of the Center for Community Change; Millie Torres, chairperson of the National Puerto Rican Coalition, accompanied by Louis Nunez, president of the National Puerto Rican Coalition.

Let me thank the panel for your patience with these hearings. We have your written statements. You also have had the benefit, I see, of listening to some of the testimony. If you see fit to allow your written statements to stand in the record and attempt to respond to any of the testimony you have heard or questions that you wish to answer, we want you to feel free in doing just that and have the flexibility to do that.

We have a time problem; so take that into consideration, too. Having said that, Mr. Eisenberg, why don't you start with your remarks.

STATEMENT OF PABLO EISENBERG, PRESIDENT, CENTER FOR COMMUNITY CHANGE

Mr. **Eisenberg**. Mr. Chairman, I am Pablo Eisenberg, president of the Center for Community Change, a national organization that provides technical assistance and other support——

Chairman **Rangel**. If the gentleman would pause. We are having a problem. You will have to speak directly into the mike. I think you should start again.

Mr. **Eisenberg**. Mr. Chairman, my name is Pablo Eisenberg. I am president of the Center for Community Change, a national organization that provides technical assistance and other support to low-income and minority-community-based organizations throughout the country. I am also one of the founders and a cochair of the National Committee for Responsive Philanthropy.

Many, if not most, of the nonprofit organizations that are taking part in these hearings have been the recipients of considerable foundation largess. The Center for Community Change is no exception. We were established with foundation money, and we continue to be dependent on this money for the work we do. But there are hundreds, if not thousands, of deserving local, regional, and national nonprofit organizations which have not been so fortunate. They currently are experiencing great difficulties in obtaining philanthropic contributions from foundations and corporations.

Foundations at their best have been the innovative, cutting-edge, and risk-taking institutions that have helped to launch new social programs, advanced the cause of research and technology, assisted disadvantaged constituencies to build the capacity for self-development and equal opportunity, challenged outmoded governmental mechanisms and strategies, and strengthened our democratic value system.

In general, however, most foundations have tended to be safe and noninnovative in grantmaking, more concerned with preserving the past than challenging the present and future. Many continue to focus more on the public needs that existed 30 or 40 years ago than on those that have currency today. The story basically is one in which the work of a relatively few institutions has provided the luster to the routine efforts of the majority.

Almost 10 years ago in a paper for the Filer Committee I wrote that:

> Foundations have channeled their funds into established national and local institutions, such as universities, research institutes, cultural and artistic groups, old line agencies and professional organizations. They have generally avoided grass roots, neighborhood, activist and social oriented organizations, either low income or middle class. Their stress has been far more on safe, respectable projects than on the cutting edge of public issues and policy. While innovators in research and technology, they have for the most part lagged behind on social and governance problems.

Despite some changes, and progress by a number of foundations, that statement can still be made as readily today as it was nearly 10 years ago. This is particularly disturbing in view of the extraordinary growth during the last 30 years in the number and variety of nonprofit organizations, many of them representing new and disadvantaged constituencies seeking opportunities, services, and influence not available through traditional channels.

In short, the priorities of foundations do not appear to have changed perceptably to accommodate the needs of those in our society who are the poorest, the most disadvantaged, and the most powerless.

Nonprofit organizations representing black, brown, and other minority constituencies, low-income people, women, the disabled, senior citizens, neighborhood and grassroots people and advocacy groups still receive a very disproportionately small piece of the foundation pie. The National Committee for Responsive Philanthropy has already cited a number of studies that illustrate this unfortunate situation.

One might have thought that the severe budget cuts over the past 2 years which have had a particularly harsh effect on these nonprofit organizations and their disadvantaged constituencies might have moved the foundations to shift their priorities significantly. However, this does not seem to have happened, although some foundations have taken remedial measures. Nor, as the conference reported a year ago, is there any indication that the corporate community and its foundations are likely to change their priorities in the next few years.

As you know, the cruel irony of these priorities is that they conflict with the very emphasis that we as a nation are placing on decentralization, local initiatives, and self-help activities. Citizens are forming new community organizations to tackle local issues and problems but can't find the money to sustain these efforts. Neighborhood and community groups, having lost Federal funds, are finding it difficult, if at times not impossible, to gain access to private sector financing. Nonprofits which are working to build the capacity of disadvantaged groups for self-advancement are being told that they are too risky or too controversial. From where then is true self-development to come from?

Foundations will remain one of the few sources from which such efforts can be funded. The extent to which foundations can shift priorities and meet this challenge will be a measure of their capacity for flexibility and innovation and meeting changing public needs. They will require all the encouragement and the incentives possible to meet this goal.

They will have to undergo a rigorous process of reassessing their priorities in the light of new public needs. They will have to become much more publicly accountable and accessible than they have been. Their boards of trustees—predominantly white, male, over 55 years of age and corporate—will have to become much more representative of the community as a whole. And, if they are to meet the test of innovation and significance, they will have to tackle much more earnestly our major societal issues and problems.

The Congress has an important role to play in helping foundations during this important transition period, first, by insuring that foundations provide sufficient information about their operations to the public and to potential grantees, and second, by removing some restrictions that appear to impede philanthropic innovation and risk taking.

Lack of access to foundations is the major obstacle faced by nonprofits that are new, small, local, advocacy in nature or represent disadvantaged constituencies such as minority, low-income and grassroots people. As long as foundations continue to operate in relative obscurity, the access problem will remain insurmountable. Public information and accountability, therefore, are a key to overcoming the access problem.

Despite all the efforts of self-regulation, fewer than 600 foundations actually publish annual or periodic reports to the public about their grantmaking. The 990's required of all foundations by IRS are not suitable substitutes for such public reporting. They are often unavailable, and do not always provide the depth of information needed for an accurate assessment of their programs. For this reason, the Congress should require all foundations of a certain size—at least the more than 3,300 foundations in the foundation directory—to issue periodic, preferably annual reports which would include the minimal information suggested in the report of the National Committee for Responsive Philanthropy, "Sunshine and Shadow."

The requirement that private foundations exercise expenditure responsibility for their grantmaking often serves as a deterrent to their support of new, unknown grassroots and controversial foundations and projects. To encourage foundations to be more adventuresome and risk taking, the Congress, in my view, should eliminate the requirement of expenditure responsibility for all grants of less than $20,000.

Another provision has also tended to prevent foundations from giving to certain nonprofit organizations. Because section 4945 prohibits foundations from giving to specific lobbying activities, many foundations have been reluctant to award money to public charities even though a portion of the resources of these charities can legally be devoted to lobbying.

The Congress should issue a clear statement, written into law, that foundations can make general grants to public charities although some of the resources of these organizations may legitimately be used for lobbying purposes.

One other restriction that should be eliminated is that which prevents local private foundations from giving to local voter education and registration campaigns. The importance of voting to good citizenship does not need to be defended here. It stands to reason that local foundations which are operating locally or within a State should have the option to give to local voter registration campaigns, particularly in view of their importance to equality of opportunity for citizenship. It thus makes no sense to keep the five-State ruling for local private foundations.

It will be easier for foundations to change their priorities in a time of expanded payouts. The reduction several years ago in the minimal payout requirement to 5 percent has therefore made priority shifts much more difficult. It also did not take into account the legitimate need for foundations to expand their giving to meet new public needs, including the crisis created by the impact of the Federal budget cuts.

There must be a balance between the desire of foundations to build or rebuild their assets and their obligation to spend their money for the purposes for which they were created. To meet this dual responsibility, the Congress should reassess its formula for the minimum payout. In my view, a minimum payout of 5 percent plus a percentage of the profits over 5 percent—perhaps 50 percent, perhaps 25 percent—would be a constructive way of both preserving foundation assets and contributing more effectively to our escalating public needs.

I would hope the Congress will seriously consider such a solution.

Thank you, Mr. Chairman.

Mr. **Rangel**. Ms. Millie Torres.

STATEMENT OF MILLIE TORRES, CHAIRPERSON, NATIONAL PUERTO RICAN COALITION, INC., ACCOMPANIED BY LOUIS NUNEZ, PRESIDENT

Ms. **Torres**. Mr. Chairman and members of the committee, my name is Millie Torres. I am accompanied by Mr. Louis Nunez who is the president of the coalition and will be available to answer any questions that may arise.

I am the chairperson of the National Puerto Rican Coalition, Inc.

The coalition is a membership organization composed of a large number of organizations and individuals interested in promoting the political, economic and social well being of Puerto Ricans in the Continental United States and Puerto Rico. In support of this basic mission, the coalition monitors and analyzes public policy initiatives, provides technical assistance and training to community groups, represents the Puerto Rican community's interests before the public and private sector, and serves as an informational clearinghouse for Puerto Rican organizations.

During the last several years, the coalition has embarked on a major programmatic thrust to enhance the institutional life of the Puerto Rican community. We believe that this effort is important and imperative for several reasons. First, the Puerto Rican community is an impoverish one. In spite of the major social and economic advances made in the 1970's, the Puerto Rican community today lags behind other groups in almost all significant socioeconomic indicators. Reports by the U.S. Commission on Civil Rights, the National Puerto Rican Forum and Aspira of America attest to the fact that Puerto Ricans in the U.S. rather than closing the gap during the decade of the seventies still remain mired at the bottom rung of the social and economic ladder.

Second, Puerto Rican institutions in the United States, the majority which are nonprofit, represent an induring source of leadership for our community. Similar to the role played by the historically black colleges in providing leadership for the black community, our nonprofit institutions have been the principal training ground for the development of Puerto Rican leadership.

In providing for the viability of our institutional life, the National Puerto Rican Coalition has an expressed interest in the responsiveness of foundation giving to the needs and concerns of the Puerto Rican community. Over the years, the coalition has tracked this issue and one of the difficulties encountered in the early phase of research is the fact that foundations have rarely been examined as to their responsiveness to the concerns of minority groups. Only recently have initial efforts been made to empirically document foundation responsiveness to Hispanic concerns, in general, and to Puerto Rican concerns, in particular.

One of the earliest efforts to assess the responsiveness of foundations to Hispanic concerns was made by the Human Resource Corp. in 1975 under a grant from the National Science Foundation. The study, based on data from the foundation center, concluded that although Americans of Spanish heritage accounted for 5 percent of the population, from 1972 to 1974 they received only 0.8 percent of all foundation funds disbursed in 1972–73. Furthermore, only 39 percent of those grants went to agencies controlled by individuals of Hispanic heritage.

More recent studies indicate that the situation has improved only slightly. A 1980 Latino Institute study found that only 1 percent of total foundation money benefitted Hispanics and only half of that money went to groups run by Hispanics. Our own research suggest that the Puerto Rican community has fared no better. Let me share with you some of the findings from our study: "U.S. Foundations' Responsiveness to Puerto Rican Needs and Concerns." I have a copy available for the record.

During the 3-year period between 1979 and 1981, Puerto Rican nonprofit organizations received only two-tenths of 1 percent of the total philanthropic grants. The total dollar value of foundation giving during that period amounted to only $7 million with 80 percent of those moneys going to Puerto Rican-controlled organizations. Only 65 foundations were recorded as supporting Puerto Rican needs and concerns during the study period. A considerable majority of those foundations which gave awarded only one or two grants during the 3-year period.

A soon-to-be-released study by the Institute for Puerto Rican Policy collaborates our findings. That study concludes that between 1977 and 1980, cumulative grant allocations to Puerto Rican needs amounted to two-tenths of 1 percent of total giving. Moreover, the study concludes that during the same period, foundation giving to Puerto Rican concerns did not keep up with increases for total giving and grants to other subgroups except blacks.

It should be noted that several foundations have shown some degree of support for Puerto Rican concerns. During our study period, over half the grants made to Puerto Rican organizations came from the Ford, Rockefeller, Robert Wood Johnson, Carnegie and Clark Foundations. The Institute for Puerto Rican Policy

Study further concluded that in terms of the percent of total domestic giving, the foundations which displayed the greatest effort were the Hazen, New World, Victoria, Carnegie and Hartford Foundations for public giving.

In summary, what does this all mean? Does it mean that if the Puerto Rican community accounts for 2 percent of the population that it should receive an equivalent percentage of foundation giving? Certainly not. However, it does point to a greater need for foundation responsiveness to Puerto Rican needs and concerns.

We believe that there are some proactive steps that foundations and this committee can take to improve this condition.

For the foundation community, we believe that there is a need for it to live up to the ideal of charitable giving, foundation dollars, by virtue of being tax-exempt, are essentially public dollars. As such, any favorable tax treatment accorded foundations must be viewed as a privilege accorded by the public. Good public policy, therefore, requires that foundations serve the general welfare by being more responsive to the needs of the less privileged groups in society.

A step in this direction is for foundations to broaden their decision framework so as to include in their board of directors and staff greater representation from the minority community. Greater diversity in trustees and staff will go a long way in assuring that groups such as the Puerto Rican community become part of the consciousness of the foundation community.

To this committee we propose that it adopt greater public disclosure and accountability requirements from foundations. The current reporting requirement, IRS–900 PF, while an encouraging step forward does not go far enough. This instrument should be broadened so as to include information such as the racial and ethnic composition of staff and board of director members.

Equally as important, Congress should require that the U.S. Treasury, through IRS, compile an annual report on the impact of private philanthropic giving. This report should be similar in scope to the one prepared by the U.S. Treasury on section 936 of the IRS Code. The importance of adequate information regarding the impact of philanthropic giving lies in that there are several publics which need to be informed about private foundations: the public composed of policymakers, the public composed of charitable organizations, and the general public.

In your framework for discussion, you asked who are the recipients of the charitable distribution of private foundations. It should be evident from the available research that Hispanics, in general, have benefited little from foundation moneys. Puerto Ricans, in specific, have fared no better. In fact, it could be concluded that with the exception of a few foundations, most have ignored the needs and concerns of the Puerto Rican community.

In summary, the coalition strongly believes that there is a need for foundations to be more responsive to minority needs and concerns. Foundations have and can play a more vital role in supporting the viability of Puerto Rican institutions. To date, however, this potential has been achieved by only a small number of foundations.

Thank you

Mr. Rangel. Thank you, Ms. Torres

Mr. Thomas.

Mr. Thomas. Thank you, Mr. Chairman.

Mr. Eisenberg and Ms. Torres, your testimony indicates that you assist various groups and I would like you to go into some detail about the manner of assisting in the direction of—have there been any changes in the way in which foundations interface with groups that are looking for assistance and to what extent has your role changed in terms of the facilitator, communicator and assistor?

Mr. Eisenberg. Mr. Thomas, clearly in the past 2 years, a great deal more work has had to be done by us in trying to help broker funds for community-based, grassroots and minority organizations, broker their entry into private sector funding because of the severe cutback in Federal funds. That has been an increasing aspect of our technical assistance. I think it is fair to point out that prior to the cutbacks one of the reasons so many local organizations became so dependent on Federal funding was that they experienced enormous difficulty in gaining access to private funding. They therefore went to where they could actually get the money.

We have noticed that some foundations and some corporations have appeared to change, have been more willing under a tremendous barrage of applications to consider the funding of organizations that they had not funded before. But I think it is also safe to say that foundation priorities generally have not basically changed even with the Federal cutbacks in the past 2½ years. Access and accountability which are so important to foundation funding remain a major problem for the grassroots organizations that we work with.

Mr. Thomas. In terms of the types of applications that are being presented, have you seen any changes in recent years in terms of foundations, for example, requiring more specificity or less specificity? I think of the analogy of block grants versus categorical grants at the Federal level. Have you seen any shift in that? That is, is it more difficult now because the project requests are more complex and you need more expertise? Is that perhaps a minimal, screening factor or are they more willing to listen to the general block grant approach where they want to do something fairly worthwhile but they don't deal in a lot of specificity in terms of the direction?

Mr. Eisenberg. Well, let me start off by saying that many foundations have always had a problem in giving general support grants to local organizations as opposed to project specific grants. If anything, there probably has been an increase toward this type of specific project funding on the part of foundations in general. There are no statistics on this matter, so that my generalization is a subjective view. Because of the tremendous cutbacks in Federal funds, much of which was general operating money, the requirement for specificity on the part of foundations is really hurting a lot of organizations.

It is also, in a way, tending to shape what should be local priorities, the way local organizations use their money determined by the decisions of their boards of directors and their mission. In many cases, foundation money helps to steer the priorities and direction of local organizations. Project-specific funding, therefore, it is creating a problem for a lot of local organizations.

Mr. THOMAS. Just a short response to that, though, it makes it more difficult but sometimes when you are required to sit down and rethink what you are and why you are there, it isn't all bad. Obviously the degree of specificity can cause problems but to be more specific about who you are and why you are doing it isn't necessarily bad. It certainly is more difficult oftentimes.

Mr. Nunez.

Mr. NUNEZ. Yes, I would say that the question of the complexity of grantsmanship depends on the size and the complexity of the foundations. As has been said today, foundations vary greatly in their process for applications but I would say, having worked in the field of fundraising in the sixties and working in it now, I would hazard a guess that it has gotten more complicated. People are much more careful. Frankly, I believe foundation officials are much more cautious and the concept of foundations being the venture capital, the people out there on the fringes is an interesting concept, but in reality I have found in dealing with major foundations that it is similar to dealing with major public funding sources. It doesn't really vary that much.

You end up having to spend a considerable amount of time negotiating, redrafting your proposals and if you are a fairly large established group and have some sophistication you can go through that process, but I sometimes wonder whether some of the smaller grassroots organizations will ever get to first base going through all of these steps in developing a viable funding plan and implementing it.

Mr. THOMAS. Some more professionalization in a way is saying more bureaucracy because there will be specificity required?

Mr. NUNEZ. It takes longer to come to a determination and it may be because of the increase in steps in the application process. It hasn't gotten any easier. You might say it has gotten more difficult.

Mr. THOMAS. Mr. Eisenberg.

Mr. EISENBERG. I would like to comment on that. I think that the professionalization of foundations has been helpful. It has enabled greater outreach to organizations that previously found foundations inaccessible. It also has lent a rational process to decisionmaking by foundations so that, in general, foundations—many of which were run irrationally and by the seat of their pants before they got professionals—are today more rationally run.

I think we have seen an improvement in the quality of grantmaking. The problem is that in many foundations there are not enough professionals to cope with the enormously escalating number of foundation proposals. Obviously foundations will run the gamut from those that are bureaucratic to those who have a sense of risk-taking, regardless of whether they are staffed by professionals or not.

Mr. NUNEZ. I just might add in terms of the technical assistance we render to our member organizations, we have embarked on a series of fundraising seminars around the country and several weeks ago, we had one in Puerto Rico where we succeeded in bringing four or five of the major foundations to Puerto Rico to meet with 60 nonprofit organizations down there. And as far as we know, this was the first, never in the history of grantsmanship had four or five major foundations sent representatives down to Puerto Rico to talk about grants and whether organizations were eligible for grants.

So it was a very interesting session. We held a smiliar one in New York City in cooperation with the Avon Foundation and we plan to do several more around the country to sensitize our community as to the realities of dealing with foundations. But perhaps as importantly to sensitize the foundations to the realities that we do have organizations that are viable mechanisms and that they have viable programs. In that group situation perhaps something might arise that will lead to some increased or new support for these groups.

Mr. THOMAS. My last question: Could you expand a little bit on the National Puerto Rican Coalition's relationship with the various groups that you deal with? To what extent is it being an intermediary between foundations that you are well aware of and steering them to the various projects and to what extent do you know about foundations and how they operate and what grants they might make available and you go out and locate groups that can get together? I am trying to figure out how you interface.

Mr. NUNEZ. Well, the groups that belong to the coalition are member organizations and they vary also in size and in their staffing and their sophistication in fund raising. Most of them do carry on independent fundraising as we do also. They pay dues to the Coalition to support its activities here in Washington and to represent their interests before the Executive and the Legislative Branches of government.

We try to bring to their attention what is going on in the foundation world. I work closely with Pablo Eisenberg's group and also work closely with the National Association for Responsive Philanthropy. We try to work together on what is going on in the foundation world and what are the possibilities for coordinated efforts. You ask me whether we are fundraising for our member organization directly; no. We try to be of assistance to them. They basically still finance themselves.

Ms. TORRES. I would like to stress that the reason why we are bringing to light the fact that there should be participation on foundation awards that is representative of the communities that we serve is that we have found as the National Puerto Rican Coalition that we must have working board members who know the communities well and participate and have credibility. Therefore, if foundations took that same responsiveness they would have people serving on their boards that could be of extreme value to them and could interface between the community and the foundation.

Mr. THOMAS. Thank you very much, Mr. Chairman.

Mr. RANGEL. Mr. Duncan.

Mr. DUNCAN. I have no questions.

Mr. RANGEL. Mr. Guarini.

Mr. GUARINI. When you mention, Ms. Torres, that 1 percent goes to Hispanic of the foundation moneys, do you have trouble getting information or difficulty getting access to the information that you need in order to present your project?

Mr. NUNEZ. The data is very mixed and our major report which focused on the Puerto Rican community was really a survey of the foundation grant index and that is not a complete report. It covers approximately 350 foundations, but it includes the 100 largest foundations.

I don't think there is a totally accurate or up-to-date listing of what foundations are doing in terms of minorities.

Mr. GUARINI. It is very dificult to get the report? You can get the report from the IRS but you have to get them all individually. They don't have all the information concerning grantees?

Mr. NUNEZ. I think a lot more work has to be done in this area and one of our recommendations is perhaps IRS with the cooperation of the Commission on Civil Rights could develop a fairly comprehensive report on this issue. It is, as far as I am concerned, far beyond the means of private entities such as ours to do the kind of in-depth research necessary. I am familiar, having worked at the Commission on Civil Rights for 9 years as to the work they can do because I have seen them do it in other areas.

Mr. GUARINI. Do you feel that the foundations are properly responding to your needs at all once you get their attention?

Mr. NUNEZ. I would say there are several small foundations that are responsive to our needs. As has been said today there are between 20,000 to 30,000 foundations. I think the number of foundations that have an interest in our community is negligible as a percentage of the total number of foundations.

Mr. GUARINI. What do you do to get their attention and get their support? Is it a matter of going hat in hand?

Mr. NUNEZ. Well, it is a matter of bringing this matter to their attention. It is a matter of meeting with them. It is a matter of sitting down with foundation officials. It is a matter of trying to get some public exposure and I think most importantly, bringing national attention to what foundations are doing in the minority world is most crucial.

I've listened to the testimony most of the day and I happen to feel that public exposure is the best way to get at this problem. I don't see the need for additional restrictions but do feel that what foundations do must be done in public view. There is no question that most of the foundations that have been presented here are very responsible groups but I have had the experience in the last year of visiting or making contact with at least 100 foundations, many who have not been as responsive.

Mr. GUARINI. Once you have their attention, do you feel that they listen to your problems or do they earmark the money where you want them to earmark the money?

Mr. NUNEZ. That depends on who you are dealing with. Some are quite responsive and others couldn't care less. The reality is that we are a small community. We are a relatively powerless community and only some foundation people are interested in our problem.

Mr. GUARINI. But you have a lot of restrictions that are placed on the money or do you have much latitude as to how the money is to be put into a project of your community?

Mr. NUNEZ. You have to prepare a proposal and describe what you are going to do. Once the foundation makes the grant, their monitoring or reporting provisions are less onerous than any public body. We do have some Federal grants and a comparison between what you have to report to the Federal Government and what you have to report to a foundation is on the magnitude of 10 to 1. So once a grant is made, I think you are clearly ahead of the game in comparison to receiving a public grant.

Mr. GUARINI. Do you have any troubles as small grantees that their credibility would not be strong enough to suit the foundations?

Mr. NUNEZ. That is a problem.

Mr. GUARINI. Do you have expenditure requirements?

Mr. NUNEZ. Are you talking about whether they are basically tax exempt?

Mr. GUARINI. That is right.

Mr. NUNEZ. Most of the organizations we deal with are tax-exempt organizations. I can support Mr. Eisenberg's position that there are a group of grassroots organizations that are effectively shut out from getting—I believe grants of $10,000 to 20,000. The current provisions could be changed to deal with the reality that there are some grassroots organizations that have not been able to secure tax exemption which, as has been pointed out, might take 6 months and cost $2,000 or $3,000 in legal fees to secure.

Mr. GUARINI. I appreciate that. Just lastly, Mr. Eisenberg, you mention that 5 percent isn't enough. It should be 5 percent plus another percentage of the profits that they make. I assume you mean from their income not from an appreciation of their stock.

Mr. EISENBERG. Yes. It seems to me, particularly in times that are economically productive, that it would be a pity to have the formula written in concrete. What I was suggesting, and others have also suggested is that there may be a way of balancing the need for building assets with getting out more money, particularly when money from the foundation world, which is risk capital, is so limited. One way to accomplish this would be to have the Congress set a percentage of foundation profits over 5 percent as money targeted to payout as well. In good times, with high rates of returns, nonprofit organizations could profit as would foundations.

In other words, such an arrangement would satisfy the need for more money out there and also satisfy the need of foundations to build or rebuild their assets.

Mr. GUARINI. Do you think the equities on the foundations are rising too quickly and the fact that they only give away 5 percent of their income where they may be earning 10 to 15 percent of their money?

Mr. EISENBERG. I am not sure of the facts on the average returns, but I do know that there are a number of foundations that are earning more than 5 percent. Depending on how they view the world and what their philosophy is, they may be spending 5 percent or more than 5 percent. We know some of them are spending as much as 12 percent, but I think that the flat 5 percent has discouraged some which could give more and are now content just giving the flat 5 percent.

If I might add just one thing, Mr. Guarini, to what my colleagues said about access. I think what the goal of all groups, whether they are a local, small emerging group or establishment organization, is equal access at the foundation marketplace. That is what it is about. Access does not insure funding, and we know that and local groups and minority groups know that. The problem is that, under the current system, equal access does not exist because so little information is available for so many people.

That is why we and others believe that it is crucial to have adequate public reporting. That is the beginning of the movement to access.

Mr. **Guarini**. When you get information from a foundation or request information, do you get all the information that you want and do you see all the grantees and the extent of their report? Do you feel that there is information that is held back?

Mr. **Eisenberg**. It depends on the nature of the report, if they do indeed issue a public report. As you know, only a small minority of foundations issue public annual reports. Those of us who have better access than a lot of local grassroots organizations have the ability to ask some of our friends in the foundation world to fill us in, to give us more information. In many cases, looking at the 990's does not tell us anything about the foundation. Very little information is often provided on those instruments. For many local groups, especially those in rural areas which are remote from regional centers, it is extraordinarily difficult to obtain copies of the 990's.

To the extent that local organizations know us or Louis or other intermediaries that helpful, they can get help, but there should be a much better system of finding out what foundations are doing.

Mr. **Rangel**. Well, I think the subcommittee has gotten your message loud and clear. It could very well be that we might consider taking excess portion of the 2-percent excise tax and see whether or not we could compile that type of directory with information for the general public. Then you can still use that interchange as to whether or not you can contact somebody on these foundations; certainly I think that, as much as we hate to have to legislate, there are some people who don't believe that the preferential tax treatment involves any public responsibility.

Let me ask you, Mr. Eisenberg, you mentioned something about removing the restrictions on lobbying. And you are assuming that most people lobby for good causes, at least causes that you agree with. What restrictions would you place on people that would like to lobby for the things that you disagree with?

Mr. **Eisenberg**. Well, in that case, I have to say what is good for the goose is good for the gander. I think that is one of the risks that one takes in a democracy—that all points of view will be heard. My only point in making that suggestion was that I think, because of the fuzziness of the current law, there are a number of foundations that hesitate to give money to public charities. If there were a clear statement written into law that, in fact, money could go to public charities despite the fact that public charities may use some of their resources for lobbying, that would go a long way toward getting more grants to some public charities. These might be progressive or they might be conservative.

In short, I think that the principle is important, even though some of the organizations that I am not necessarily in favor of would gain by that provision.

Mr. **Rangel**. Let me go directly to the expert. You can lobby, can't you? There is just a restriction?

Mr. **Nunez.** There is a restriction on the percentage of one's budget what you can use to lobby with.

Mr. **Rangel.** I am asking Mr. Eisenberg, would you want to remove that restriction?

Mr. **Eisenberg.** No. I am saying that some foundations, because of the restriction against specific lobby activities will, in giving general support grants, find themselves specifically prohibiting any lobbying out of those funds, although such action is not required by the law.

Mr. **Rangel.** Well, what could we do if specific foundations restrict themselves as to where they make specific grants because of lobbying? What could we do about that?

Mr. **Nunez.** Well, Congressman, if I may interject, I think there is some confusion in the interpretation of the specific law regarding lobbying of nonprofit or charitable organizations. Perhaps the Congress could clarify it. I have read various interpretations of what you can and can't do. It is at times a puzzling issue. I have met with foundations who have told me point blank, "We can't give if you do any lobbying."

Mr. **Rangel.** OK. It could be cleared up. But even assuming that we have the power to do that, we still have to wonder if you are going to take the risk that Mr. Eisenberg seems to be willing to take. And that is that, while you would encourage people to make grants for what you want to lobby, or whether or not public interest funds should be used to lobby, it may be the very things that you are trying to prevent from happening in communities.

In any event, we have to give it some thought. I am going to ask the Council of Foundations to try to come up with some specific guidelines since they deal with a lot of problems that we don't in Congress. I would also like the Council to see if they can give us some assistance in determining whether or not the 2-percent excise tax could be used to provide a Federal directory.

I am also concerned about expenditure responsibility, Mr. Eisenberg. I think it is your testimony that for certain grants, $25,000 or $20,000, that the oversight roles should be eliminated so that foundations would be involved in more risk taking. How would you then have accountability? What is to prevent abuse in this area where foundations merely identify friends and relatives for scholarships and grants, with no reports at all? How would you handle that?

Mr. **Eisenberg.** Well, by removing the expenditure responsibility, I am not suggesting that foundations should not require reporting by organizations to which it gives money. It seems to me that if such organizations were to misuse that money which is, in effect, a misuse of money under a contract, then they would be susceptible to normal penalties that other organizations are subject to. I think the foundations can, in fact should, require reporting from small organizations that are new or don't have 501(c) status.

I don't suggest that they should throw their hands up and then say, "Because we are now removed from that responsibility, we are not going to require reports at all." I think they certainly should do so.

Mr. **Rangel.** Mr. Thomas.

Mr. **Thomas**. On that point, you indicated a $20,000 grant for the elimination of the requirement of expenditure responsibility. H.R. 3043 has a $15,000 level and I assume there is no quibbling over those amounts, but I did not ask you. I would like a reaction from either or both of you, if you have taken a look at H.R. 3043. Do the suggested changes in the 1969 act contained in H.R. 3043 help, hurt or really not make any difference in terms of trying to bring about some of the things that you are interested in accomplishing?

Mr. **Eisenberg**. It certainly would be acceptable to have a $15,000 expenditure responsibility exemption limitation. The reason I use $20,000 is that in our experience, new organizations that are beginning, need some professional time and have to set up a little office and will probably need in its first year of operation a little more than $15,000 to really get going. So I use $20,000 as an example of what might be the minimum needed. $15,000 would be fine.

I think there is some question about whether, in fact, tax breaks should be given on the same basis to private foundations as a means of generating new foundations without some quid pro quos. I am not sure that all the data is in on it and I take the line that NCRP did in questioning that. I don't know. I would certainly stand by a thorough study of that question. But it seems to me that there might be incentives given in terms of new tax breaks for what could be a new type of private foundation that meets certain minimum requirements, such as more representative boards, foundations which give more than the 5 percent, say, 6 percent, that do not give excessive remuneration to trustees, that abide by more stringent public accountability requirements, possibly including an annual hearing of the trustees for the community.

It seems to me that this would be a good opportunity in exchange for the tax break to provide some public accountability, a quid pro quo, if you will.

Mr. **Thomas**. So you could have good foundations and admirable foundations based upon the way in which they operate.

Thank you, Mr. Chairman, very much.

Mr. **Rangel**. We thank you for your contribution.

The United Negro College Fund testimony that would have been given by Christopher Edley, who is the president, will be inserted in the record in its entirety. He was unavoidably delayed.

The record will remain open in case there are other recommendations that you would like to make to this subcommittee, and certainly the subcommittee would like to contact you or the staff in case we run across some recommendations that we would like to make. We thank you for your contributions to the subcommittee.

Our next panel of witnesses represent the regional associations of foundations; Southeastern Council of Foundations, Robert H. Hull, executive director; Donors Forum of Chicago, Eleanor P. Petersen, president; Council of Michigan Foundations, Dorothy A. Johnson, executive director; and Associated Grantmakers of Massachusetts, Inc., Janet C. Taylor, executive director.

May I call Mr. Hull, executive director of the Southeastern Council of Foundations.

STATEMENT OF ROBERT H. HULL, EXECUTIVE DIRECTOR, SOUTHEASTERN COUNCIL OF FOUNDATIONS

Mr. HULL. Thank you, Mr. Chairman, members of the subcommittee. My name is Robert Hull, executive director of the Southeastern Council of Foundations, a regional association of some 225 grantmaking foundations in the Southeastern part of the United States. We want to express our appreciation for the opportunity to testify today.

In order to express our gratitude, we will do our best to observe the 5-minute limit.

Our testimony about the collaborative efforts of foundations will be done in a collaborative manner. After my brief introduction my colleagues will present in series some examples of, we think, creative collaboration among foundations which are pertinent to the interests of these hearings.

First of all, the kinds of collaboration which serve the general public, particularly the grant-seeking public; then the kind of collaborative efforts which serve the foundation community and tend to improve the capacity and the effectiveness and the efficiency of the foundation community to go about its grant-making business; and then; finally, some collaborative efforts which have to do with joint grants which directly increase the effectiveness of an individual donor.

There are currently 17 formally organized regional associations of foundations in the country, with approximately 1,500 member organizations, and while many of those foundation members are very large ones, many are smaller, unstaffed foundations with very local grant interests—the kind of foundations often unwilling to associate or be involved in any kind of activity beyond their very local level.

The major impetus for the establishment of regional associations is rather new, with perhaps one notable exception. The major impetus came after the Tax Reform Act of 1969. Foundations formed local associations around appropriate geographic areas, whether in a metropolitan area, multicounty areas, State levels or multiState levels. They formed those associations to keep themselves informed of legislative and regulatory developments, to aid their member organizations in the compliance with a new set of regulations, to improve the efficiency of foundation operations, to analyze local needs, to collaborate in grant efforts and, finally, to give the public an added focus as to the interests and activities of the foundation community.

We feel that it is significant to the purposes of these hearings that since 1969 these voluntary groups of foundations have appeared independently across our country with a common goal of improving the performance of the foundation field by a variety of voluntary means.

No two associations of foundations are exactly alike in their programs or their emphasis since they usually respond to the local kinds of needs, but within associations of foundations can often be found the following kinds of activities which are pertinent, we believe, to your interests here: Sponsoring seminars and workshops for both donors and donee groups; publishing newsletters, annual reports and directories of foundations; researching data on grantmaking at the local level; communicating to the general public about the philanthropic world; informing donors about possible new and broader roles they might play in their areas; instructing donee groups on effective fundraising; operating Foundation Center regional libraries for research on philanthropy; enhancing donee organizations on several levels of operation; and finally, analyzing community needs.

We feel that these kinds of activities of collaboration are a new and unique kind of phenomena in the foundation world and my colleagues will now give you some more specific examples of these kinds of activities which can relate to these hearings.

[The prepared statement follows:]

STATEMENT OF ROBERT H. HULL, EXECUTIVE DIRECTOR, SOUTHEASTERN COUNCIL OF FOUNDATIONS

My name is Robert H. Hull, Executive Director of the Southeastern Council of Foundations, and Chairman of the Committee of Regional Associations of Grantmakers of the Council on Foundations.

The testimony which follows will be presented by a panel of four persons, all of whom are associated with regional associations of grantmaking organizations, comprised largely of private foundations. This testimony contains information for the Subcommittee on various activities of foundations within associations which we deem to be pertinent to the interests of the hearings. The testimony will be given in four parts: after my brief introduction, my colleagues will cite examples of foundations providing information and other services to the public in association with other foundations; examples of associated foundations offering services to the foundation field to improve its capacity to provide meaningful grants to the charitable field; and examples of collaborative efforts among foundations which have enlarged the benefit of grants to donees.

There are currently seventeen (17) formally organized regional associations of foundations and other grantmaking organizations in the country, with approximately 1500 member organizations. While many of the foundation members of these associations are large, many are smaller, unstaffed foundations with very local grant interests.

The major impetus for the establishment of regional associations, with a few notable exceptions, was the Tax Reform Act of 1969. Foundations formed local associations around appropriate geographic areas (metropolitan, multi-county, state, or multi-state in scope) to keep themselves informed of legislative and regulatory developments, to aid compliance, to improve the efficiency of foundation operations, to analyze local needs, to collaborate in grant efforts and to give the public an added focus as to the interests and activities of the foundation community. We feel that it is significant to the purposes of these hearings that since 1969 these voluntary groups of foundations have appeared independently across our country, with the common goal of improving the performance of the foundation field by a variety of voluntary means.

No two associations of foundations are exactly alike, in program or emphasis, since local concerns have determined their various directions. Within associations of foundations can often be found the following kinds of activities: sponsoring seminars and workshops for both donors and donee groups; publishing newsletters, annual reports and directories of foundations; researching data on grantmaking; monitoring legislative activity; communicating to the general public about the philanthropic world; conducting annual conferences that address topical issues; informing donors about possible new and broader roles; instructing donee groups on effective fund raising; operating Foundation Center regional libraries for research on philanthropy; enhancing donee organizations' effectiveness through consultation services; assessing community needs; and evaluating grant proposals.

The testimony which follows contains specific examples of relevant foundation activity.

Mr. GUARINI. Thank you, Mr. Hull.

Ms. Eleanor P. Petersen. We welcome you.

STATEMENT OF ELEANOR P. PETERSEN, PRESIDENT, DONORS FORUM OF CHICAGO

Ms. PETERSEN. Thank you. I am Eleanor Petersen for Donors Forum of Chicago, which is composed of 152 independent, family and corporate foundations and corporate giving programs. Let me say right now that I am very happy that in one sense the regional associations have followed the panel which immediately preceded us because I think that many of the concerns which that panel expressed are of greatest concern to those of us in the regional associations. That is not only in the leadership of our associations but of all of our members.

Certainly there is probably no area of greater concern to all of you and to all of us than the area of openness and none that is more difficult and complex to deal with. Regional associations have tried in many different ways to become more open and to encourage their members toward greater openness. There are many examples of this. One of the most dramatic and probably effective is the annual meeting which the Minnesota Council on Foundations holds twice yearly, once in Minneapolis-St. Paul and once in another rural part of the State.

Six hundred to a thousand persons attend these meetings with the opportunity to meet and discuss their joint problems and concerns with the grant makers present. Another smaller effort but equally effective is a series of meetings called "Dialogs With Donors", in Chicago, and Boston and spreading to other regional associations.

In addition, regional associations help to take their members out into the communities. Regional associations in Los Angeles, in Detroit, New York, hold frequent meetings between their members and representatives of not-for-profit organizations. Everywhere there is a reaching out between the grant maker and grant seeker.

I am particularly proud of the Donors Forum of Chicago, because on our board of directors of 21 persons there are three grant seekers. One is an executive director of a small neighborhood agency for runaways; a second is a president of a major cultural institution; and a third is the executive director of an Hispanic organization. On our four major program committees, the composition of these committees is almost half grant makers and half grant seekers. It is a true reaching out to work together with the donee community.

In addition to these activities all regional associations have most pertinent and interesting publications. The Michigan council puts out a first rate annual directory of foundations as does Massachusetts and a number of other associations.

The Donors Forum happens to do grants lists of its members, and other associations puts out studies of philanthropic behavior. All regional associations work very hard to help and to encourage their members to publicize grants lists, to print annual reports, to publish their guidelines. All regional associations are working to bring grant makers and grant seekers together.

Finally, I would mention the very important part of many regional associations programs which are the regional association libraries which not only provide pertinent information to grant seekers but provide technical assistance services as well as other services. These regional associations are part of the Foundation Center collection. The Foundation Center is the producer of an enormously useful amount of information to the foundations. Their publications are found in more than 130 collections in public libraries, in addition to such specialized collections as are held in regional libraries.

Among the publications of the Foundation Center is the Data Book which lists 22,000 foundations including names, assets, addresses, grants made. In addition there is the Foundation directory which prints the names and pertinent information of all foundations in the United States with assets of more than $1 million numbering well over 3,500, with pertinent information of the foundations for grant seekers.

Again, regional associations share the committee's great concern that all foundations are not as open or forthright as they might be but we are determined and are optimistic that there is certainly growing openness throughout the country.

Thank you.

[The prepared statement follows:]

STATEMENT OF ELEANOR P. PETERSON, PRESIDENT, DONORS FORUM OF CHICAGO

Foundations are reaching out into their communities to provide information about how foundations operate and for themselves, to learn more about their community's needs.

Foundations are seeking to open up dialogue with grantseekers—dialogue that will help create cooperation and understanding between those making grants and those seeking them.

This growing openness is happening across the country and is especially prominent in areas served by Regional Associations. Here grantmakers are uniting their efforts to devise ways to become more accessible. The Minnesota Council on Foundations annually holds public meetings which attract hundreds of persons. The monthly Dialogues with Donors Series bring donors and donees together in both Boston and Chicago. Foundation luncheons feature discussions between Regional Association members and local representatives of not-for-profit organizations. Small family foundations enjoy day long field trips to grassroots organizations out in the city neighborhoods. Donors Forum of Chicago has put public representatives on its Board and Committees. Thus, in many different ways, Regional Associations seek with their large and small foundation members, to understand and become more responsive to the broad philanthropic community.

An especially important service to grantseekers are the Regional Association Libraries which contain collections of Foundations Center materials. Not only have these Libraries served more than 10,000 persons annually, but they provide a number of technical assistance programs to improve ways in which grantseekers research possible funding sources.

The written word reaches out beyond personal contacts by means of a large number of Regional Association publications. These range from the useful state directories, analysis of members' grants, to indepth research reports on the foundation community. Quarterly Regional Association newsletters also help to carry information far beyond the Associations' membership. A special effort by their members to publish annual reports and guidelines is producing results even among smaller foundations. The directions that these reports contain are extremely helpful to the success of the grantseekers' efforts.

The former attitude of private foundations that their grantmaking is also private has changed dramatically in the last decade. Today, foundations are sensitive to the need to be accountable and accessible and by all indications, their awareness will continue and their efforts toward openness will grow.

Mr. GUARINI. Thank you very much, Ms. Petersen.

I would like to ask Ms. Dorothy Johnson, executive director of the Council of Michigan Foundations, to proceed.

STATEMENT OF DOROTHY A. JOHNSON, EXECUTIVE DIRECTOR, COUNCIL OF MICHIGAN FOUNDATIONS

Ms. JOHNSON. Thank you. I am here to tell you why the public is better off because of grants made by foundations and the assistance they have received from regional associations.

I would like to dwell on two points, one, how foundations comply with the law; and two, how they make grants.

I think it is evident when looking at complying with the law from Mr. Mill's comments, when he introduced these hearings yesterday that abuses of 1969 have been taken care of. Foundations are doing a good job. Likewise, the GAO report which you heard about earlier today reports a 98-percent compliance on tax reporting by private foundations after some followup.

This has happened in part because of assistance that regional associations have provided their members—the how to sessions, the technical assistance. Private foundations have gone beyond just complying with the law, we can talk about complying with the spirit of the law—the grantsmanship seminars that have attracted the 250 grassroot community people in the Detroit area; we can talk about the public meetings but we also recognize the problems and we are working to do something about them.

A stark reality of all the activity we have generated however are better grant proposals for greater needs with fewer resources. A concern of ours is that H.R. 3043 be passed to allow for more foundations to respond to these needs. We have heard a difference of opinion on private foundation statistics during these hearings. The Foundation Center has reported that current grant dollars have increased 30 percent, but in real value there has been a 4-percent decline. The 1969 Tax Reform Act has done the job in cleaning up the problems and abuses but it has affected growth.

In regards to making grants, a foundation's purpose of course, regional associations sponsor meetings with foundation managers, donors, trustees, and staff to discuss how they do a better job with the grant process. In Michigan there are only 43 staffed foundations out of the more than 800 in the State. Their payout rate—I would emphasize this—was 7.8 percent in 1981. All you need do is come to our State to see the need. Foundations have responded.

We have been hearing a lot about foundation phone numbers at these hearings. We publish a directory, here it is, and of those foundations listed with assets over $200,000, 75 percent of them have listed phone numbers. I would be happy to share this for the record.

This is not unlike what is going on in every other regional association across the country. I would like to share with you briefly a sample of the programs that you would see in any given town in the United States.

In Los Angeles in recent weeks it has been on adolescent pregnancy; in Chicago on Hispanic needs; in Atlanta on investment procedures; in Boston on evaluation; in Detroit feeding the hungry; and the list goes on.

But of course the results of all this activity are the bottom line and why you have given foundations the favored tax status and why we support a change in the law. I could share with you hundreds of "if it hadn't been for the foundation" type stories but four examples from the State I know best, Michigan follow: In Detroit 130 families are being served in a Latino mental health clinic; 680 families through a Salvation Army program are receiving food; in Fremont, Mich. 25 homebound individuals have transmitters which with the push of a button will bring assistance and scholarship programs.

Then there are foundations with assets between $10,000 and more than $1 billion who are repsonding to our State's economic problems. Together with universities, labor unions and business corporations, they have started a michigan investment fund, they have been instrumental in beginning an industrial institute of high technology, and all of this is to create more jobs.

But that list goes on and on in most every community throughout the United States. We appreciate your consideration at this time of existing foundations and hopefully potential foundations which can do even more.

Thank you.

[The prepared statement and letter follow:]

STATEMENT OF DOROTHY A. JOHNSON, EXECUTIVE DIRECTOR, COUNCIL OF MICHIGAN FOUNDATIONS

Mr. Chairman, Members of the Subcommittee, I am Dorothy A. Johnson, Executive Director, Council of Michigan Foundations and I appreciate the opportunity to testify before you with my colleagues on why the public is better off because of the foundation grants and the services provided by regional associations of grantmakers.

Regional Associations exist to help their members. Today I wish to discuss two services regionals provide which directly relate to why you have called these hearings, as well as how the results of these services benefit the public. Regional Associations help foundations do a good job of both complying with the law and in making grants which respond to society's needs.

COMPLYING WITH THE LAW

In the matter of compliance, the recent General Accounting Office Study of private foundations, presented at the May 11 Subcommittee on Commerce, Consumer and Monetary Affairs Hearings, revealed that 98 percent of private foundations comply with the tax portion of the law. I think you will agree that is a remarkable record. Regional Associations have helped foundations achieve such a high level of compliance by providing them with "how to" programs, written publications and technical assistance in completing the 990 tax form.

Not only do Regionals assist foundations in completing the required forms, but we also assist in fulfilling the "spirit of the law" relative to public reporting and public accountability—the printing of annual reports, publishing directories, sponsoring public meetings and coordinating grantsmanship seminars for human services agencies and community groups.

As a result of these initiatives, foundations daily receive more and better proposals for funding, and these proposals are more clearly and effectively targeted to respond to society's needs. Ironically, in the face of greater and greater need, both the assets and grantmaking capability of private foundations have declined in real dollar terms over the past two decades.

This stark reality is why many Regional Associations of grantmakers, including the Council of Michigan Foundations, are supporting the Conable/Shannon Bill H.R. 3043. This bill will increase the amount of charitable resources available to meet ever increasing needs, while also lessening the administrative burden of foundations for expenditure responsibility grants and address several other technical problems. The Tax Reform Act of 1969 has done a good job in eliminating abuses. But portions of the 1969 Act have also affected, oftentimes unintentionally, the growth of foundations and the type of organizations and projects foundations are able or willing to fund. The Conable/Shannon Bill will help correct these problems.

MAKING GRANTS

Of course, a foundation's purpose is social betterment through the making of grants to organizations and projects. In any given week, all across the country, Regional Associations are convening foundation managers, trustees, and staff to discuss how to do a better job with the grant process as well as to analyze specific community needs and problems. Attending these meetings are donors, trustees and staff who have the public interest at heart and who want to do the very best grantmaking job possible. For the most part, they are volunteer trustees . . . in Michigan, for example, 43 foundations out of more than 800 employ any staff.

Just in the past few months, grantmakers have gathered at the initiation of a Regional Association in New York City on "Housing the Homeless"; in Dallas on "Cooperative Projects in Agriculture"; in Los Angeles on "Adolescent Pregnancy"; in Kansas City on "Concerns in Giving to Higher Education"; in Boston on "Monitoring and Evaluating Grants"; in St. Louis on "The Unemployed"; in Chicago on "Needs of Hispanic Community"; in Atlanta on "Foundation Investments: Policies and Practices"; in San Francisco on "Ethical Issues in Philanthropy"; in Minneapolis on "Perspectives on the Urban Indian Community"; in Seattle on "High Risk Areas for Kids"; and in Detroit on "Feeding the Hungry".

There are not travel junkets or national conference on esoteric topics. These are local meetings to address local issues and what foundations might do to address them.

RESULTS

Thus, Regional Associations reflect the desire of foundations to work cooperatively and to be accountable and responsive to the public. Yet, it is the results of their efforts which must represent the real "bottom line" as to why foundations have favored tax status, and why regional associations support changes in the existing law. In that regard, I could share with you thousands of "if it hadn't been for the foundation" stores from across the country. However using Michigan, the state I know best, as an example I can tell you that foundations with assets of $10,000 to $1 billion, are having an impact. They—

are helping 111 low income families of cancer patients in Midland, Michigan receive financial assistance to offset the devastating cost of cancer treatment.

are helping 130 clients of the Latino Mental Health Task Force in Detroit receive services every month.

are helping 25 homebound persons obtain wireless transmitters which at a push of a button will trigger a message for help in Fremont.

are helping thousands of students receive scholarships for college education and vocational training.

are helping 680 families eat in a Salvation Army program in Detroit.

are joining with government, universities and businesses to form a venture capital fund, and an Industrial Technology Institute, so that our economically depressed state of Michigan can revitalize its economy and create jobs.

The list goes on and on, in most every community throughout the United States and with similar diversity of foundation support and activities.

We appreciate your consideration and review of private foundation tax law at this time—a period in which existing foundations and potential new foundations can and want to do even more. Thank you.

Council of Michigan Foundations,
Grand Haven, Mich., June 23, 1983.

Re hearings on private foundations and written testimony from Council of Michigan Foundations.

Mr. John J. Salmon,
Chief Counsel, Committee on Ways and Means,
Longworth House Office Building, Washington, D.C.

Dear Mr. Salmon: Charitable contributions by more than 800 Michigan foundations have made a difference to the well-being of the people in our state and elsewhere. In your news release dated May 3, 1983 you asked, "what role do private foundations play in private philanthropy and what philanthropic activities are private foundations undertaking?"

Last year Michigan foundations expended more than $250 million for human needs. Michigan foundations paid out 7.8% of their assets which total slightly over $3 billion. A sample of what Michigan foundation's charitable grants mean to the people of our state and country follows:

The Capuchin Mission's soup kitchen in Detroit, which now feeds more than 2,000 people a day, received $2,000 from the Earl-Beth Foundation in Grosse Pointe to continue feeding Detroit's hungry people.

Since it began in 1981, Hospice of Kalamazoo has enabled 122 terminally ill patients to die at home with dignity, proper medical care and non-medical back-up support and also has served 339 families. Among the agency's supporters is the Harold and Grace Upjohn Foundation, whose grants totalling $45,000 have helped the program to begin.

United Way agencies in Grand Rapids expect to save 19 percent on their annual energy costs for 12 different buildings, thanks to a $5,000 grant from the Dyer-Ives Foundation. This enabled United Way to hire a consultant to set up an Energy Conservation Fund to provide free energy audits for its agencies.

A $20,000 grant from the Barstow Foundation in Midland went to the Salvation Army in Detroit last year. The agency estimates these funds will provide food and toys for 680 families or 2,700 persons.

Alpena Community College set up a volunteer center last year with a $24,045 grant from the Besser Foundation. In one year, 1,306 people, from high school students to adults, contributed 33,968 hours of work to 92 different agencies in the community.

The Bauervic Foundation in Troy challenged Shrine High School in Royal Oak to raise $10,000 for a career guidance center. In six months, the sum was raised from nearly 350 alumni, parents and parishioners, who donated from $1 to $1,000 and went on to give $4,839 more. The foundation matched it all with $14,839. The high school development officer says the momentum carried into 1983. Donations so far this year total $140,000 compared to a total last year of $90,000.

A $5,000 general-support grant from the Jesse Besser Fund in Alpena provided the only non-public dollars in the budget of the Latino Mental Health Task Force in Detroit, a multiracial agency that provides counseling services for 130 regular clients every month and nearly 400 walk-ins during a year.

This year, the University of Michigan will be able to provide full scholarships—tuition, books, room and board—for the first two Bentley Scholars, chosen for their high academic excellence in a variety of disciplines. When the program is fully functioning in four years, it will support eight scholars, with an estimated annual grant of $48,000 from the Alvin M. Bentley Foundation in Owosso.

A $4,000 grant from the Samuel Higby Camp Foundation in Jackson contributed to a building fund for a new Foote Hospital, a facility that replaces two older hospitals in the community that had received 52 citations for building violations. To bring the facilities up to code would have cost up to $28 million more than the new $68.9 million hospital is expected to cost.

One hundred eleven low-income families of cancer patients in Midland County have received financial assistance from the Midland County Cancer Society to help them pay for the devastating cost of cancer treatment. A $100,000 grant last year from the Elsa U. Pardee Foundation supported the program, which over the years has received more than $2 million from the foundation.

The United Foundation in Detroit received $1.3 million from the Chrysler Corporation Fund for the 136 charitable agencies in Wayne, Oakland and Macomb Counties that are UF members. If all giving were eliminated, the Fund would still make a gift here because it is considered so important, officials say.

The Economic Alliance for Michigan, a major coalition of top business and labor leaders in the state, is addressing such major economic problems as increasing utilization of existing resources, developing new businesses and jobs and improving the cost of conducting business in Michigan. A seed grant of $75,000 from the Hudson-Webber Foundation in Detroit enabled the Alliance to get underway and contributed to its first 18 months of operation.

Reflecting its belief in the philosophy of united giving, the General Motors Foundation last year contributed $3.4 million to 46 United Way campaigns in communities where General Motors has facilities.

Each year in the nation's 3,078 counties, one 4-H member is recognized for overall achievement and becomes a Ford Achievement Award Winner, the highest award a 4-H member can receive. From these county winners, one member is selected to represent the state at the National 4-H Congress in Chicago, where a dozen young people are honored with college scholarships and two also have the opportunity to visit with the President of the United States. This achievement program, funded for many years by the Ford Motor Company Fund, last year was supported with a $100,000 grant to the National 4-H Council for the scholarships, program administration and the Chicago trips for the state winners.

Twenty-eight arts organizations and the Detroit Medical Center have been able to take a hard look at their organizations using strategic planning grants from the Eloise and Richard Webber Foundation. The grants, which totalled more than $2 million over the last two and one-half years, enabled the organizations to bring in consultants who assisted them in planning to better organize themselves to face the future.

A small grant for a feasibility study has led to the establishment of a $20.5 million venture capital fund to help an economically depressed state revitalize its economy. Creation of the Michigan Investment Fund (MIF), in turn, has led to a new use of foundation investment portfolios. The $15,000 grant, made by the Charles Stewart Mott Foundation in Flint to the National Development Council in Washington, D.C., resulted in a study which revealed that only $41 million venture capital was available in Michigan from nine firms, compared with reported Massachusetts figures of nearly $1 billion in capital available from 63 sources. The Mott Foundation spearheaded the establishment of MIF and committed $4 million of its investment portfolio for use by MIF, which currently has attracted seven other investors and limited partners. The project also has stimulated interest from the national philanthropic community.

A campaign to raise funds for 104 units of new housing for senior citizens in Midland got underway with a challenge grant from the Rollin M. Gerstacker Foundation, which promised to contribute up to half the cost of the $4.5 million project if the community could raise the other half.

Historic Loranger Square in Monroe is being redeveloped, thanks in part to a $1,000 grant from the Herman and Irene Gertz Foundation, which matched local Kiwanis Club efforts. Both grants were made to the Community Foundation of Monroe County for the first phase of beautification efforts in a four-block downtown area. To raise their funds, Kiwanians "sold" old bricks found under the paved street, which were reclaimed and cleaned up by Boy Scouts, Cub Scouts and others before being re-laid in the center of the square.

A private foundation, a community foundation and its service agency, volunteers and a hospital are all involved in a Fremont-area program to link homebound elderly and disabled or frail people with emergency medical care. Twenty-five persons are being selected to wear a small, wireless transmitter that will trigger a message to the Gerber Memorial Hospital at the push of a button. The project, just underway, is funded by a grant of $8,500 from the Gerber Baby Foods Fund to the Fremont Area Foundation, which matched the gift with $9,250 and established the Art Friends Lifeline Fund to support the effort.

A $5,000 grant from the Jensen Foundation in Ann Arbor helped Child and Family Services of Washtenaw County purchase a truck that is used to transport food from its food bank to community agencies that feed the hungry.

The UCLA School of Medicine is establishing a scholarship and loan fund for disadvantaged minority students with a gift from the Gordy Foundation in Detroit. The program funded with annual installments of $10,000 up to a total of $60,000 commitment, will provide one-year scholarships of up to $5,000 each to Barry and Bertha Gordy Scholars and establish the loan fund as well.

To help revitalize Michigan's industry and stimulate its economic growth, the Industrial Technology Institute in Ann Arbor is conducting basic and applied research in technologies that could benefit the state, helping manufacturers use that technology, and providing leadership to develop a new multi-billion-dollar industry—automation equipment and software. The institute encourages partnership between universities, labor and industry, and provides a setting for such programs. Last year, the institute received a Kellogg Foundation commitment to provide $9 million in funding over the next three years, which may be increased by $4 million, and could total $40 million over a 10-year period. The Herbert H. and Grace A. Dow Foundation in Midland has provided seed money for the Institute as well as committing $10 million over the next ten years.

The Kresge Foundation in Troy recently made the final payment on a $6 million grant to the Capital Resources Development Program of the United Negro College Fund. This grant, the largest in the history of the foundation, challenged UNCF to raise the remaining $22 million needed to reacy its $50 million goal. The funds will be used for renovation and construction projects, faculty and curriculum development and endowments for the 41 colleges that are UNCF members. UNCF met its goal.

Over the past five years, the Hurst Foundation has contributed $150,000 to the Feelin' Good-Living Well cardiovascular health education program through the Michigan Heart Association in conjunction with the public and parochial systems in Jackson County. All county residents are potential recipients of this program, aimed at improving fitness through cardiovascular types of exercise coupled with nutritional education.

Four hundred fifty-one people—90 of them children—were sheltered between late January and May of 1983 on an eastern Detroit facility operated by the Coalition of Temporary Shelters (COTS). With a $50,000 grant from the McGregor Fund, COTS refurbished a church gymnasium used by needy people who required shelter for five to 15 days until more permanent living quarters could be found. Housing expenses of COTS clients are not reimbursed by public funds. COTS also operates another shelter and a soup kitchen, which served 4,000 meals during this time period.

Last year, the C.S. and Marion McIntyre Foundation in Detroit made the final payment in a $1 million pledge to the Endowment Challenge Fund at Alma College. The general-support grant leveraged another $8 million for the college's endowment.

The B.D. and Jane McIntyre Foundation in Detroit pledged $450,000 in 1980 to endow a chair in business at Hillsdale College.

A $50,000 grant from the Edward and Irma Hunter Foundation enabled Fernwood, a conservatory with rare botannical gardens, to maintain the facility and helped endow facility maintenance.

Over the last five years, the Kantzler Foundation in Bay City has contributed nearly half a million dollars to help the city enjoy its river environment through the development of riverbank parks. Last year, a $50,000 grant enabled the City of Bay City to complete an arboretum on the river's west side.

The Morley Brothers Foundation in Saginaw made its first matching grant recently, challenging the 1,200 employees of Saginaw General Hospital to contribute to the cost of a CT Scanner, priced at nearly $900,000. The foundation expects to grant about $25,000 to the hospital's foundation when the two-year challenge period is over. The hospital already has raised about 70 percent of its goal.

When federal dollars to the Michigan Cancer Foundation were cut last year, the Meyer and Anna Prentis Family Foundation in Detroit stepped in with a $325,000 grant to help the research and treatment organization fill the funding gap.

Fountain house in New York helps people discharged from psychiatric hospitals to live independently and free from government support by providing an array of support services and finding them jobs. Last year, the George M. and Mabel H. Slocum Foundation in Birmingham granted $9,000—one-seventh of its total grant dollars—for general support of this agency, which has served as a model of psychiatric rehabilitation for 140 similar facilities nationwide. Last year, 102 of these facilities offered transitional employment programs, worked with 540 employers and leveraged 1,210 fulltime and part-time jobs for former psychiatric patients who then earned an aggregate of $4.6 million.

A $4,000 grant from the La-Z-Boy Chair Foundation in Monroe enabled the Newton, Mississippi, Fire Department to purchase Jaws of Life equipment to assist in removing auto-crash victims from their vehicles. A grant the previous year purchased the Jaws for the Siloam Spring, Arkansas, Fire Department.

A $10,000 grant from the Ruth Mott Fund in Flint to the Waste Systems Institute of Michigan helped to underwrite and distribute a biweekly newsletter concerned with the management of solid, hazardous and toxic waste. In a year's time, subscriptions to The Michigan Waste Report—aimed at the general public, business, industry, policymakers, agencies and others—rose from 100 to 450.

Elderly people who attend a senior day-care center in Detroit are transported from their homes to Calvary Services for the Aging in a van equipped for the handicapped and paid for with a $15,000 grant from the Mary Thompson Foundation in Grosse Pointe to Bon Secours Hospital and Luthern Social Services of Michigan.

With $20,000 from the Charles J. Strosacker Foundation in Midland, Midland-Gladwin Community Mental Health Services was able to make 327 presentations about the dangers of substance abuse in every school in the county, involving 7,600 schoolchildren. The grant also enabled the agency to provide counseling about drugs to elderly county residents.

A study of work-sharing as a way to prevent layoffs in industry was conducted by the deputy director of the California Commission on Institutional Innovation with a $5,000 grant from the Upjohn Institute for Employment Research in Kalamazoo. The study has been used by industries in Michigan and elsewhere.

A 23-year-old Grand Haven woman was able to complete her medical technology studies at Garden City Osteopathic, thanks to a $2,700 grant from the Wigginton

Educational Foundation. The woman, who was graduated this month, had exhausted all other resources in order to further her education.

Over the last three years, the Albert L. and Louise B. Miller Foundation has committed over $5 million to an economic development project in the central business district of Battle Creek, that will have leveraged $100 million in public and private capital investment and that will involve 1,000 employees.

Kalamazoo and Hope Colleges—private, liberal arts schools—each received $150,000 from the Harry A. and Margaret D. Towsley Foundation in Ann Arbor to provide fellowships and scholarships for students preparing for careers in science and health.

A $5,000 gift from the George R. and Elise M. Fink Foundation in Harper Woods is helping an ecumenical service agency that aids between 70 and 90 poor and forgotten people in Detroit every day. Crossroads, the social service unit of St. Paul Cathedral, has four employees and 110 volunteers who provide immediate relief for the disadvantaged as well as back-up support services to solve the underlying problems.

In 1981, the Aeroquip Foundation in Jackson made a commitment of $120,000 for the new Foote Hospital, which replaces two aging medical facilities in the community.

Two young people with medical difficulties were among the 90 persons who received scholarships last year from the Windship Memorial Scholarship Foundation in Battle Creek. One young man whose diabetes and epilepsy will become crippling now holds a master's degree in business administration from the University of Michigan after receiving $9,600 in scholarships from the foundation over six years. The other, a woman was born without bones in her fingers and has undergone multiple surgeries to correct the defect, will graduate this year from Kellogg Community College with an associate degree in physical therapy. She received $750 a year for books, tuition and fees.

In an effort to stimulate private giving, the JSJ Foundation matches gifts made by JSJ Corporation employees to four-year colleges of their choice. Last year, the foundation matched $15,200 given by 77 employeess to 31 schools.

When a national manufacturer closed a plant in Grand Haven, the Loutit Foundation purchased the property as an asset and later sold it to another industry that would keep the plant and property in use and provide new jobs in the community. The Grand Isle Marina Group will use the facility to manufacture pleasure boats and, later on, precast concrete docks for other marinas. About 30 jobs will be created and possible industrial blight will be averted.

Because less technology training is available in Grand Rapids that any other city of its size in the industrial world, the Rapids-Standard Foundation has supported engineering programs at Grand Valley State College for the last three years as the institution converts these programs from two years to four.

This year, the Dorothy U. Dalton Foundation in Kalamazoo committed $45,000 so the Borgess Mental Health Center (DeLano Clinic) can hire another staff psychiatrist to meet new accreditation requirements and thus continue to receive third-party payments for care. The foundation already had provided $88,000 for general support of the agency, which serves Kalamazoo and Allegan counties.

Residents of Schoolcraft, a small town (pop: 1,300) in southwestern Michigan, were perfectly willing to volunteer all the labor necessary to build a sports complex for their high school. Local business was willing to donate use of construction machinery and to furnish materials at cost. A fund-raising campaign altered the Vicksburg Foundation in Kalamazoo to the project. With grants of $5,000 in 1981 and $10,000 last year, the community was able to purchase the necessary materials to get started. The project, expected to take four to five years, is well underway and a track is nearing completion.

For the last five years, the Jack F. Wolfram Foundation in Lansing has made payments on a $250,000 commitment to Michigan State University for its new performing arts center. This grant, the project's first large gift from a private foundation, enabled MSU to leverage other foundation dollars.

The Lyon Foundation in Birmingham last year gave one-tenth of its grant dollars—$5,000—to help the Ranserly Library in London distribute books used to teach reading to people around the world.

Youth Assistance Program that helps young people in trouble with the law were aided last year with a $139,600 grand from the Skillman Foundation to the Juvenile Court of Oakland County. The funds provided staff training for directors of the assistance program in twenty-five communities as well as student training and staff supervision in three areas: the assistance program, a volunteer program that draws about 1,000 volunteers and a family camp. In the last five years only 15 percent of the youth cases placed with this program have gone to court.

Last year a $40,000 grant from the Kendall Foundation in Battle Creek to Kellogg Community College provided scholarships to 71 students in the Allied Health Fields, helped 34 people complete training in a nurses aide/home care health aide training program, provided three programs in a concert lecture series that drew good audiences and provided consumer health education classes attended by more than two thousand people. The grant also supported three consumer health fairs that drew 1,000 persons.

This information has been compiled by the Council of Michigan Foundations (CMF), an association of 165 grantmakers including private and community foundations, corporate giving programs and banks serving foundations. Foundation members in the state retain assets from $10,000 to more than $1 billion. These members represent 90 percent of the foundation assets in our state. CMF has a service program, as described in the enclosed brochure, which assists Members in fulfilling their grantmaking responsibilities. CMF supports the Conable/Shannon Bill H.R. 3043 recently introduced in the House of Representatives which would increase the amount of charitable resources available to meet ever increasing needs.

Sincerely,

RANNY RIECKER,
Chair, Council of Michigan Foundations.
DOROTHY A. JOHNSON,
Executive Director, Council of Michigan Foundations.

Mr. GUARINI. Thank you, Ms. Johnson.

The executive director of the Associated Grantmakers of Massachusetts, Ms. Janet Taylor.

STATEMENT OF JANET C. TAYLOR, EXECUTIVE DIRECTOR, ASSOCIATED GRANTMAKERS OF MASSACHUSETTS, INC.

Ms. TAYLOR. Thank you. Thank you for this opportunity.

I think the information that Dottie Johnson provided in terms of the growing number of requests and the need for donors to respond to ever-changing and emerging needs has encouraged the spirit of cooperation that we facilitate by the meetings and educational activities offered. What is important is the independence of our respective members in setting their priorities and making funding decisions.

Our role is to provide an opportunity for them to come together to understand the needs in their communities and to identify ways that they might address those needs in a manner that eliminates duplication of effort and focuses the resources in a most effective way.

My written testimony highlights examples of this activity in cities such as Chicago, Boston, Los Angeles, and Kansas City and in Michigan and Texas. Each addresses a different need ranging from hunger problems to mental health and recognizes the economic realities in our communities.

Each one provides the donors a means for responding within the limits of their own capabilities and resources. Some may support short-term emergency responses, while others may provide a longer-term view and fund research and data collection necessary to address the ongoing and serious problems in our communities.

I have also highlighted the approach of addressing a recurring problem with a new solution, by citing the example of the emergency loan funds. This concept originated in San Francisco with the northern California grantmakers and expanded to 17 other communities. What is significant is that the pressure on dollars and charitable resources has caused the donors to look for ways to recycle that money.

In the emergency loan funds, the initial funding is used again and again through the repayments of the loans to assist yet more organizations. I think this example reflects the spirit of creativity and the desire to help community agencies in the ways that donors can do best. It brings together the various expertise and understanding that such a diverse constituency as we represent can bring to bear on the problems.

We appreciate this opportunity and I would be happy to respond to questions.

[The prepared statement follows:]

STATEMENT OF JANET C. TAYLOR, EXECUTIVE DIRECTOR, ASSOCIATED GRANTMAKERS OF MASSACHUSETTS, INC.

Mr. Chairman, Members of the Subcommittee, I am Janet C. Taylor, Executive Director of Associated Grantmakers of Massachusetts, Inc. in Boston. Thank you for this opportunity to share with you some of the exciting collaborative efforts initiated by the foundation and corporate members of regional associations of grantmakers.

The members of regional associations of grantmakers are private foundations, community foundations, and corporations with charitable giving programs. Each member is autonomous, setting its priorities and making grant decisions independently. The regional associations facilitate communication and promote a spirit of cooperation among their diverse and independent members.

Through their educational activities, regional associations make their members aware of emerging community needs and provide a forum for addressing local problems in a cooperative and constructive way. They help to eliminate duplication of effort and serve to focus resources where they are most needed. Regional associations bring together local interests, public and private, and enable them to forge new relationships while preserving the autonomy of the various partners.

The following examples of collaboration among foundations and corporations reflect the unique characteristics of the communities where the projects were initiated. The nature of the problem, the available resources, and the existing mechanisms all influence the particular solution which is appropriate for each community. Even where projects have been replicated, the variations in approach demonstrate a flexibility to adapt to local needs.

RESPONDING TO COMMUNITY NEEDS

The steady stream of funding requests to foundations and corporations represents an important source of data about emerging community needs. Often the donors have the most comprehensive view of the situation and recognize the need for an immediate and more coherent response than their unilateral decisions can provide. Through the regional association, they are able to obtain an objective assessment of the situation and to develop a framework for responding. Often there will be no single solution but a multi-faceted reflecting the priorities, resources and capabilities of the participating foundations and corporations. For example:

Three years ago, the Donors Forum of Chicago focused on food pantries at one of its regular Program Profiles meetings. The members learned about the efforts and needs of Second Harvest, the Greater Chicago Food Depository, and local soup kitchens. In response, corporations involved in the food industry launched a program of in-kind donations which continues today. Several independent foundations responded with cash for staffing and operations. Recently, local banks have provided technical assistance in real estate and financing for the purchase of a new facility for the Depository.

In 1971 in response to the Nixon Administration's cuts in Model Cities and Neighborhood Youth Corps, the members of Associated Grantmakers of Massachusetts, Inc. (AGM) initiated a coordinated effort to address the needs of urban youth for summer activities. The emphasis on agency collaboration, racial and ethnic integration, and program quality which was established then has continued. In 1983, 48 foundations and corporations committed $905,000 to 62 programs serving over 20,000 low income and special needs youth in the Boston area.

The interaction of government officials and private foundation representatives at last fall's annual conference of the Council of Michigan Foundations stimulated initiatives to address the state's economic realities. Within 24 hours of the conference, 3 foundations based 500 miles outside Detroit directed funds to the city's hunger problems; another dozen foundations subsequently provided assistance. Michigan foundations are now helping to finance an investment fund to develop long-term solutions to revitalize the state's economy. These efforts have become the theme for next fall's conference.

The Cooperative Projects Committee of the Conference of Southwest Foundations is the focal point for several initiatives by Texas foundations to deal with the economic and human problems along the Mexican border. A current example is a mental health project funded by 5 foundations and operated by the University of Texas Medical School. To promote improved understanding of the clients' needs, the staffs from mental health facilities on both sides of the border participate in educational conferences and staff exchanges.

A meeting at New York's Port Authority Bus Terminal sponsored by the New York Regional Association of Grantmakers in September, 1981 brought together public sector officials, nonprofit service providers and foundation representatives concerned about the city's homeless population. The responses from 18 different foundations reflect their varied funding priorities and capabilities in addressing the same problem: some directed their assistance to short-term emergency needs while others funded research and data collection or became involved in the longer-term housing problem. Several participants from the original meeting are now part of a task force on housing.

In Kansas City, an 8-year $3.8 million primary health care project is serving low-income elderly and high-risk youth as a result of the project broker role played by the Clearinghouse for Midcontinent Foundations. In addition to 8 local foundations, the Robert Wood Johnson Foundation is a partner in the program.

Discussion of collaborative funding at the recent annual conference of the Southern California Association for Philanthropy led to the formation of the Collaborative Funding Service. The service is designed for small and medium-sized foundations which often are unable to provide full funding for a project. It identifies the program interests which donors have in common, thereby enabling a foundation to contact directly other donors who might join in funding a project.

NEW APPROACHES TO SOLVING PROBLEMS: EMERGENCY LOAN FUNDS

Sometimes new approaches are needed to solve old or recurring problems. The unique vantage point of foundations provides a perspective for making such an assessment and offers an opportunity to do something. When this occurs, the regional association plays the role asked of it by its members—as educator, researcher, convenor, or implementer.

The emergency loan fund concept is an example of a creative solution to a recurring problem. It originated in 1973 when 4 foundation executives in San Francisco became concerned that nonprofit organizations were experiencing cash-flow problems because of delays in government contract payments. The Emergency Fund Committee on the Northern California Grantmakers was created to bring together bank and foundation resources to provide emergency grants and low-interest loans. This new mechanism could do what the individual parties could not accomplish as well—re-cycle charitable dollars to meet community needs and provide leverage to address the problems in the system.

Ten years later, 23 donors are involved in the San Francisco project which provided $1.5 million in grants and loans to 61 agencies in 1982. And there are 17 other emergency loan funds around the country with others in the planning stages. In Chicago, Michigan, Minnesota, Los Angeles, and Boston, the regional associations played a key role in launching these efforts, drawing upon the expertise in San Francisco and elsewhere. To illustrate the value of these mechanisms in using charitable resources effectively, in Boston the initial funding of $90,000 from 15 donors has been used to make $280,000 worth of loans in two years.

CONCLUSION

All of the regional associations of grantmakers began operations after passage of the 1969 Tax Reform Act. The examples cited above reflect the commitments of their members to be professional and effective in their grantmaking activities. Other examples abound, as in the current work on program-related investments, the impact of new office technology, and management assistance for nonprofits. The most exciting aspect of our work is the strong desire among our foundation and corporate members, large and small, to work together and with their colleagues in nonprofit organizations and government to meet community needs. Thank you for your interest.

Mr. GUARINI. Thank you all for your testimony.

I would call on Mr. Thomas, please.

Mr. THOMAS. Thank you, Mr. Chairman.

How are these regional associations funded? Is it through dues from the members?

Mr. HULL. Yes. Generally dues, although they sometimes differ in how they are based.

They are always from the members.

Mr. THOMAS. And they are growing so I assume they think they are getting something for their money.

Mr. HULL. Apparently, yes.

Mr. THOMAS. I heard discussed some of the joint projects going on, funding in a joint way. I assume the associations would be useful in assisting these activities instead of foundations going out on their own. In fact, I assume you encourage pooling. Does that occur?

Ms. TAYLOR. I think the thing we try to do is encourage a pooling of effort but preserving the independence of each foundation to make its own grants. So the structure is: here is the problem, here are the many ways that you can address it. One approach might be to fund a particular organization, another approach might be to fund several organizations as in our summer funding process.

We have in Boston 64 different summer programs being funded by 48 different donors with checks going directly to the individual programs.

Mr. THOMAS. Do you find any problems with some of the smaller foundations, maybe not wanting to be part of the whole—they want the identity—and some of the larger foundations not wanting to share the spotlight. Do you have PR problems with that? Does that occur?

Ms. JOHNSON. One-third of our 165 members having assets of less than $1 million, respond quite differently. These are volunteer donors often leaders in our State in other capacities and they want to cooperate but they also like the fact that they can come to professional staffed operations and find the answers to some of their questions.

Mr. THOMAS. If regional associations are a growing factor and I assume as needs increase in the pooling concept that will continue, where do you folks think you will ultimately fit in in terms of the whole area of foundations? In 5 years will we be looking at legislation as to what associations can and cannot do? I am trying to guess where you will be 5 years from now and anticipate the fact that we did not do what we should have done because we now have a novel creature of pooling of resources.

Is any of this thinking going on in terms of how valuable the regional associations are and how you can do more if you changed the structure?

Mr. HULL. We do think about that a lot. We have not decided exactly what will happen 5 years from now. The pooling concept, I think, might be overstated. There is some of that going on. I think we all favor that concept as an expression of efficiency.

Using a multiple source of funds to attack a particular problem is great. That probably doesn't happen nearly as often as we would like. So we are not at the point of worrying about some negative consequences of this positive kind of function. I am afraid I don't at least have an answer to your question.

Mr. **Thomas**. How many of your associations were not in existence 5 years ago?

Ms. **Petersen**. One has been formed in the last 3½ or 4 years, the regional association in New York.

Mr. **Hull**. Yes.

Mr. **Thomas**. Most of these have been around for some time?

Ms. **Petersen**. Most came up at the time of the Tax Reform Act. There has been one around longer than that, the Southwest Council.

Mr. **Hull**. Yes.

Mr. **Thomas**. Thank you, Mr. Chairman.

Mr. **Guarini**. Mr. Duncan.

Mr. **Duncan**. I want to thank the panel. It has been very good. I have no questions.

Mr. **Guarini**. Let me ask you. You have a national council. That council is nationwide in regard to performing the same functions you performed originally, is that correct?

Mr. **Hull**. To some degree, yes.

Mr. **Guarini**. Do they represent all the foundations or just the large ones?

Mr. **Hull**. Their membership is approximately 1,000 and that includes the larger foundations in the country, of course.

Mr. **Duncan**. That is a very select group then?

Mr. **Hull**. No, the Council on Foundations has members who are also smaller, some of whom you heard from today and some even smaller than those you heard from.

Mr. **Duncan**. What determines whether they pay the dues in your organization?

Mr. **Hull**. Purely voluntary.

Mr. **Duncan**. The same with your individual regional groups.

Mr. **Hull**. Right.

Mr. **Duncan**. What percentage of the foundations actually belong to your groups?

Ms. **Johnson**. In Michigan we represent 92 percent of the assets in the State.

Mr. **Guarini**. That is assets.

Ms. **Johnson**. Right. We have 165 members of the 800.

Mr. **Duncan**. About 25 percent of the members then.

Ms. **Johnson**. Four hundred of the 800 foundations have assets of less than $100,000. I would only add that the Council on Foundations provides superior national leadership but regionals are in existence to help their local members do a better job making grants locally. The National Council has encouraged our formation.

Mr. **Guarini**. Is your relationship with the smaller members as close and significant as for the larger members?

Ms. **Petersen**. That is probably one of the best roles for regional associations to maintain ongoing working relationships with small family foundations that have no staff at all. In Chicago, for instance, of our membership, about 151, we have 76 corporate foundations that are giving programs. The balance of our programs are between independent and family foundations and is overwhelmingly family foundations. There are only a dozen independent foundations with staff in our city. That means the bulk of our membership are family foundations without staff and they play a very active and ongoing role in our organizations.

They like to cooperate with each other and they piggyback at times on some bigger foundations' projects.

Mr. GUARINI. Do you have criteria for membership or can anybody join? Do they have to comply with certain requirements?

Ms. PETERSEN. They apply and the requirement is that they are a grantmaker, that they don't seek funds but they make grants and give funds away.

Mr. GUARINI. The reason I ask is if there are any abuses amongst foundations, do you have any jurisdiction within your organization to ferret it out or to make a report on it or to be able to bring it to the attention of your association?

Ms. PETERSEN. I think probably the most significant factor we would have would be simply the pressure of their colleagues. For instance, in one way we have seen that work in terms of publishing annual reports. More and more of our members publish annual reports or guidelines because of the pressure of their colleagues who are already doing that to have them do it. I think probably if there is any apparent transgression there is now through a regional association a united kind of philanthropic community that has within itself the kind of coordination and communication that makes pressures possible among the members.

Mr. GUARINI. Are there still as many grantors we can get a report from or get adequate information? In other words the reporting requirements are not strong as they should be according to testimony I have heard.

Do you do anything in your association to require more systematic or organized accountability on the part of your foundations?

Ms. PETERSEN. We can only do it through persuasion and example. We have—we do not, for instance, have a criteria that you must publish an annual report in order to be a member of our regional association.

Mr. GUARINI. Do you think it would be a good requirement by the committee or by administrative law to have better and/or complete reports published on the part of all foundations?

Ms. PETERSEN. Do I think that that would be a good idea to have legislation on that?

Mr. GUARINI. Do you think reporting is adequate at the present time?

Ms. PETERSEN. Is the reporting adequate now?

No, I would agree, most of us would agree that we wish many more foundations published their annual reports or at least their guidelines than do now, but I think what we are encouraged about is the whole emphasis is on doing that now.

Mr. GUARINI. Are there any areas of conduct on the part of the, or abuses on the part of foundations that you could bring to their attention or that you have a way of ferreting out by peer pressure or your rules and regulations?

Mr. **Hull**. Anything that relates to unresponsiveness, we encourage our members to at least be courteous to those who apply, to give a prompt response even if it is a negative response. Of course again the only sanction we have is the pressure of the group. We offer that as a good example and sometimes it is effective, sometimes of course it is not effective.

Mr. **Guarini**. I saw a television program last night that said the America Cup is financed by taxpayers' money, that the foundations are a significant contributor, $50 million of taxpayers' money is involved. What do you do within your organization if you find these things coming to your attention? Do you sanction it? Do you think this is a proper use of foundation money as professionals in the field?

Mr. **Hull**. I did not see that program. I cannot say——

Mr. **Guarini**. Did any of you see it?

I guess not. You prefer not to have seen it.

Ms. **Taylor**. One of the things that our educational programs are geared to do is to provide information on current reporting requirements and the other kinds of activities that are either legally expected of foundations or morally ought to be brought to their attention. Sometimes it is simply making them more aware which broadens their understanding of their own role.

We also encourage more than the published reports that the annual reports represent by promoting participation in the open meetings, publishing directories, and arranging face-to-face contacts with grantees at the "Dialogues with Donors."

Mr. **Guarini**. In regard to grassroots grantees, do you find the expenditure responsibility requirements are making it difficult for the grassroots grantee to approach a foundation and be successful in the grant it gets?

Ms. **Taylor**. It has been an inhibiting factor in our membership.

Mr. **Guarini**. Do you have any recommendations?

Ms. **Taylor**. I think the provisions of H.R. 3043 would help address that significantly.

Ms. **Johnson**. I would agree with Ms. Taylor.

Mr. **Guarini**. Do you feel, Ms. Johnson, the foundations make themselves accessible and accountable to the various grantees, particularly the grassroots grantees?

Ms. **Johnson**. I can tell you our membership does. I cannot speak for 862 foundations.

Mr. **Guarini**. Is there any other opinion on the panel? Is this a problem of accessibility that we have among the other foundations to grassroot grantees?

Mr. **Hull**. I don't think foundations are as accessible as they ought to be. I don't know if only to grassroots organizations but to any new organization that comes along, whether it is called grassroots or otherwise. Some of that I think relates maybe more to my part of the country in that we have very few staffed foundations in the southeast. If new organizations come along asking for consideration there may be no one to investigate that organization and to inform the other trustees about the validity of the request.

Consequently, it is often sometimes not necessarily desirable but it is the only alternative they see, to choose that with which they are familiar.

Mr. Guarini. Thank you, Mr. Hull.

Are there any other questions?

I want to thank the panel for their helpfulness and we thank you very much.

I would like to call from the Hospital Corporation of America, Donald S. MacNaughton, chairman of the board, accompanied by the Honorable Wilbur D. Mills, counsel.

Mr. McNaughton, Mr. Mills, we particularly welcome you as two very distinguished Americans, one the former head of Prudential Life Insurance Co. and the other, the former chairman of this Ways and Means Committee, and one of the leading tax attorneys of our Nation.

We are happy to have you here.

Mr. Mills. May I take a moment to present to the committee Mr. MacNaughton. I have known him for a number of years, when he was chairman of the Prudential Life Insurance Co., and I thought he had retired. But when he left Prudential he went to the Hospital Corporation of America and has made it a very fine and large organization rendering a great service to the American people.

It is headquartered in Nashville, in Mr. Duncan's State of Tennessee. It is a pleasure to be here with Mr. MacNaughton.

Mr. MacNaughton. Thank you, Mr. Mills.

Mr. Guarini. Mr. MacNaughton.

STATEMENT OF DONALD S. MacNAUGHTON, CHAIRMAN OF THE BOARD, HOSPITAL CORPORATION OF AMERICA, ACCOMPANIED BY WILBUR D. MILLS, COUNSEL

Mr. MacNaughton. Mr. Chairman, members of the committee, for the record I am Donald S. MacNaughton. I am chairman of the board of directors of Hospital Corporation of America. I would like to summarize my remarks and submit the full text for the record.

The Hospital Corporation of America or as it is more familiarly known, HCA, is engaged in the business of owning, operating and managing hospitals in the United States and abroad.

First incorporated in 1960, HCA now owns or manages more than 350 hospitals. We are a for-profit corporation and we pay taxes. The common stock of the corporation is publicly held and listed on the New York Stock Exchange.

As we have grown, our interest in philanthropic activities and our contributions to a wide variety of charities have also grown. In 1982 HCA's cash corporate contributions exceeded $1 million. Because of our desire to increase our philanthropic activities in a responsible fashion, we became interested last year in the establishment of a private foundation. As stated in the HCA foundation's charter the specific purposes of the foundation include important social needs such as medical and scientific research, treatment of disease, and medical and scientific education and training.

As you know, many of these needs historically have been addressed by a major commitment on the part of the Federal government. The commitment we all know remains strong but inevitably must be balanced against other competing Federal responsibilities during a period of increasing budgetary pressures.

We fully anticipate that the HCA foundation will become in time a major contributor to the public good.

This worthy and ambitious project obviously will require extensive contributions and a long-term dedication at charitable goals. HCA determined that a contribution of $30 million could firmly establish the HCA Foundation in the forefront of medical philanthropy.

However, HCA being a publicly held corporation and having a duty to its shareholders believed that the transfer of the entire $30 million to the foundation in a single year would not be in the best interests of HCA's shareholders. Furthermore, a single contribution of $30 million from a corporation the size of HCA would not be economically feasible.

HCA developed an alternative contribution plan that would diminish the impact on HCA's shareholders and still assure the foundation that it would receive the entire $30 million from HCA. Instead of giving stock all at once, HCA would grant to the foundation an option to purchase 1 million shares of HCA stock. The option would be similar to the kind of stock options a corporation grants employees. Basically the option entitles the recipient to purchase the corporate stock at a fixed price. This option could be exercised by the foundation at any time in whole or in part during a 10-year period at a price determined by the stock's closing price on the New York Stock Exchange on the date of the grant of the option.

The value of the stock on the date of the granting of the option would be approximately $30 million. In addition, HCA would continue to contribute $3 million in cash every year to the foundation during the 10-year period. At the end of the 10-year period the foundation would have sufficient funds to exercise the full option if it chose to do so.

At the time the foundation completes the transaction by exercising the option, the value of the stock would in all likelihood be worth even more than the $30 million.

As a result of this contribution plan, the foundation would be established and given the flexibility not provided by a single cash contribution or a single transfer of stock. For example, the foundation could choose not to exercise the option at all and instead utilize the accumulated funds to acquire other assets.

Probably most important of all, however, the foundation could also have the opportunity, if it waited until the end of the 10-year period, to purchase 1 million shares of HCA stock at a price frozen 10 years ago.

Clearly, there are substantial benefits for the foundation resulting from this contribution plan.

The current tax law would permit each phase of the plan, that is, the granting of the option and the annual donations, but perversely, current law does not permit the foundation to accept the main benefit; that is, the right to exercise the option.

Current law imposes an excise tax on certain transactions described as acts of self-dealing. Such acts include the sale or exchange of property between a private foundation and the substantial contributor to that foundation.

Thus, we have a classic catch-22 situation. The grant of the option is not prohibited, the annual contribution of cash to the foundation in order to provide it with sufficient funds to exercise the options is not prohibited, but the exercise of the option is prohibited.

The ironic result of present law is that it serves to hurt only the foundation and, therefore, retard its charitable efforts.

The primary legislative purpose behind enactment of this excise tax on acts of self-dealing was to discourage abusive tax transactions involving the purchase and sale of closely held stock, securities and other property.

The potential for abuse arose in the valuation of such stock or securities. The underlying reason for the rule may well be as valid today as it was in 1969. But the rule is nonetheless too restrictive.

The prohibition applies not only to the abusive transaction by which a donor is able to manipulate the price of its stock for price advantages, but also to the transaction in which the donor does not have such manipulative capability because the stock is actively traded on a highly regulated public market.

In addition, the blanket statutory prohibition does not recognize the fact that when the foundation exercises the option, it is merely completing a single transaction, a transaction which would be perfectly permissible under current law had HCA been able to donate $30 million at one time rather than granting an option to be worth $30 million with annual contributions of smaller amounts.

Gentlemen, given the acknowledged abuse of the few corporations and their private foundations in the past, we would certainly understand if Congress expressed a reluctance to advocate an easing of these transactions. Although I believe no one can challenge or impugn our motives and intentions, we too are concerned that a change in rules be tightly drawn so as to preclude any unscrupulous practice in this area.

There are a number of possible ways to modify existing law to permit responsible transactions between foundations and their substantial contributors while at the same time ensuring that abusive transactions between such parties continues to be prohibited.

We would support limiting the allowable transactions to securities that are actively traded on an established market. This method of determining value is already well recognized in the Internal Revenue Code and could not impose a burden on the IRS.

Also, to assure that a foundation be precluded from making a decision not in its own best interests, we propose that such transactions be allowed only if the price of the stock when exercised is above the option price.

If there are additional concerns we welcome the opportunity to work with your staff and Treasury staff to develop specific language that would satisfy all parties and that could be included in any omnibus bill you may propose.

Thank you for your time and attention.

Mr. GUARINI. Thank you very much, Mr. MacNaughton.

[The prepared statement follows:]

STATEMENT OF DONALD S. MACNAUGHTON, CHAIRMAN OF THE BOARD OF HOSPITAL CORPORATION OF AMERICA

My name is Donald S. MacNaughton and I am Chairman of the Board of Directors of Hospital Corporation of America.

Hospital Corporation of America (HCA) is engaged in the business of owning, operating and managing hospitals in the United States and abroad. First incorporated in 1960, HCA now owns 212 hospitals and manages 150 others, for a total of 52,000 beds. We are a "for-profit" corporation and we pay taxes. The common stock of the corporation is publicly held and is listed on the New York Stock Exchange.

As we have grown, our interest in philanthropic activities and our contributions to a wide variety of charities have grown. In 1982 HCA's cash corporate contributions exceeded $1 million. Because of our desire to increase our philanthropic activities in a responsible fashion, we became interested last year in establishing a private foundation. As stated in the HCA Foundation's charter, the specific purposes of the foundation include important social needs such as: (1) Medical and scientific research; (2) Treatment of disease; and (3) Medical and scientific education and training. In addition, the Foundation's charter provides for making grants and contributions in the areas of the arts, human relations, civic and social improvement. As you know, many of these needs historically have been addressed by a major commitment on the part of the Federal government—a commitment which we all know remains strong, but inevitably must be balanced against other competing Federal responsibilities during a period of increasing budgetary pressure. HCA is adhering to the very highest standards in establishing the Foundation. We fully anticipate that the HCA Foundation will become—in time—a major contributor to the public good.

This worthy and ambitious project obviously will require extensive contributions and a long term dedication to these charitable goals.

HCA determined that a contribution of $30 million could firmly establish the HCA Foundation in the forefront of medical philanthropy.

However, HCA, being a publicly held corporation and owing a duty to its shareholders, believed that the transfer of the entire $30 million to the foundation in a single year would not be in the best interests of HCA's shareholders. Furthermore, a single contribution of $30 million from a corporation the size of HCA would not be economically feasible.

HCA developed an alternative contribution plan that would diminish the impact on HCA's shareholders and still assure the foundation that it would receive the entire $30 million from HCA. Instead of giving stock all at once, HCA would grant to the foundation an option to purchase 1,000,000 shares of HCA stock. The option would be similar to the kind of stock options a corporation grants employees. Basically, the option entitles the recipient to purchase the corporate stock at a fixed price. This option could be exercised by the foundation at any time (in whole or in part) during a ten year period, at a price determined by the stock's closing price on the New York Stock Exchange on the date of the grant of the option. The value of the stock on the date of the granting of the option would be approximately $30 million. In addition, HCA would contribute $3 million in cash every year to the foundation during the ten year period. At the end of the ten year period, the foundation would have sufficient funds to exercise the full option if it chose to do so. At the time the foundation completes the transaction by exercising the option, the value of the stock would in all likelihood be worth even more than $30 million.

As a result of this contribution plan, the foundation would be established and given the flexibility not provided by a single cash contribution or a single transfer of stock. For example, the foundation could choose not to exercise the option at all and instead utilize the accumulated funds to acquire other assets. Probably most important of all, however, the foundation could have the opportunity (if it waited until the end of the ten year period) to purchase 1,000,000 shares of HCA stock at a price frozen 10 years before.

Clearly there are substantial benefits for the foundation resulting from this contribution plan. Current tax law would permit each phase of the plan, i.e. the granting of the option and the annual donations; but perversely, current law does not permit the foundation to accept the main benefit—the right to exercise the option.

Current law imposes an excise tax on certain transactions described as acts of "self-dealing". Among the transactions penalized is the sale or exchange of property between a private foundation and a substantial contributor to that foundation. While the law would not prohibit the corporation's initial grant of the stock option to the foundation, the statutory provisions would effectively prohibit the foundation's exercise of the option. The I.R.S. views the granting and exercise of such an option as two separate transactions, which would run afoul of the "self-dealing" rules. Actually, there is only one transaction: An offer by the corporation at the time of granting the option; and an acceptance by the foundation when it exercises the option.

Thus we have a classic "Catch-22" situation. The grant of the option is not prohibited. The annual contribution of cash to the foundation to provide it with sufficient funds to exercise the option or otherwise carry out its charitable purpose is not prohibited. But the exercise of the option is prohibited.

The ironic result of present law is that it serves to hurt only the foundation and therefore retard its charitable efforts. We believe that we may complete this transaction by having the foundation sell the option to another charitable institution and still preserve our charitable deduction and we have asked the I.R.S. to confirm this. In this scenario there would be no loss to the Treasury, no loss to HCA, but the foundation would have incurred substantial expenses in arranging for the go-between to buy and exercise the option. To have foundation funds expended for financial services rather than charitable purposes must be contrary to the intent of Congress.

The primary legislative purpose behind the enactment of this excise tax on acts of "self-dealing" was to discourage abusive tax transactions involving the purchase and sale of closely-held stock, securities and other property. The potential for abuse arose in the valuation of such stock or securities. By its nature, closely-held stock does not usually have an easily-ascertainable fair market value. Thus, the donor, in establishing the value of the stock for tax purposes, could arbitrarily set the price and transfer the stock to the foundation at a grossly inflated or deflated price, which could result in either an income tax or estate tax advantage for the donor.

In 1950, Congress attempted to restrict the opportunity of donors to receive substantial benefits from dealings with their foundations. The Revenue Act of 1950 imposed a statutory arm's-length standard on certain transactions including the sale of stock or securities between a foundation and its substantial contributors. Congress believed that this standard would ensure the accurate valuation of the property and eliminate manipulation of the stock price.

In the years following the enactment of the Revenue Act of 1950, the I.R.S. found the provisions difficult to administer and enforce because each individual transaction had to be reviewed and tested in accordance with the subjective arm's length standard. Therefore, in 1969, Congress decided the simplest solution was to impose an excise tax on all sales or exchanges of securities or other property between a foundation and a substantial contributor to that foundation. The imposition of this excise tax effectively prohibited all such transaction.

While this blanket prohibition is undoubtedly easier to administer and the underlying reason for the rule may well be as valid today as it was in 1950, the rule is nonetheless too restrictive. The prohibition applies not only to the abusive transaction by which a donor corporation is able to manipulate the price of his stock for tax advantages, but it also applies to a transaction in which the donor does not have such manipulative capability because the stock is actively traded on a highly regulated public market.

In addition, the blanket statutory prohibition does not recognize the fact that when the foundation exercises the option, it is merely completing a single transaction—a transaction which would be perfectly permissible under current law had HCA been able to donate $30 million at one time, rather than granting an option worth $30 million with annual contributions of smaller amounts.

HCA recently requested that the I.R.S. review its contribution plan and rule that the grant and subsequent exercise of the stock option be viewed as a single transaction, not subject to the prohibition on dealings between foundations and substantial contributors. The I.R.S. felt compelled to issue an adverse ruling, but not because they believed that the HCA plan contained inherent potential for abuse or that it violated fundamental principles underlying the corrective provisions of the 1969 Act. Rather, the I.R.S. simply ruled that the language of the statute was so restrictive and all-encompassing that they could not rule otherwise.

We are requesting a legislative remedy to resolve this matter. As you recall, the purpose behind the prohibition of sales and exchanges of property between foundations and their substantial contributors was to prevent the manipulation of fair market value of their own stock and securities to obtain a tax advantage for themselves. Such transactions are abusive and should be prohibited. But the prohibition should not extend to transactions in which the value of the stock can be readily and accurately determined.

Gentlemen, given the acknowledged abuses of a few corporations and their private foundations in the past, we would certainly understand if Congress expressed a reluctance to advocate an easing of these prohibited transactions. And although I believe no one can challenge or impugn our motives and intentions, we, too, are concerned that a change in the rules be tightly drawn so as to preclude any unscrupulous practice in this area.

There are a number of possible ways to modify existing law to permit responsible transactions between foundations and their substantial contributors while, at the same time, ensuring that abusive transactions between such parties continue to be prohibited.

We would support limiting the allowable transactions to securities that are actively traded on an established market. This method of determining value is already well recognized in the Internal Revenue Code and would not impose an audit burden on the I.R.S. Also, to insure that a foundation were precluded from making a decision not in its own best interests, we propose that such transactions be allowed only if the price of the stock when exercised is above the option price.

CONCLUSION

Very simply, we are bringing a provision to your attention that we believe is more restrictive than necessary to accomplish its purpose. We believe the stock option transaction we described is free of potential for abuse and a useful procedure that can and should be utilized. We believe that this type of transaction can be utilized without a return to the abuses of the past or a raid on Treasury. In fact, we believe this proposal is revenue neutral.

If there are additional concerns, we welcome the opportunity to work with your staff and Treasury's staff in order to develop specific language that would satisfy all parties and that could be included in any omnibus bill you may produce.

Thank you for your consideration.

Mr. GUARINI. Mr. Mills, do you wish to add anything?

Mr. MILLS. No, thank you, Mr. Chairman.

Mr. GUARINI. I would like to know for the record, to make it clear, the foundation that you have in mind is not in existence today, is it?

Mr. MACNAUGHTON. Yes, the foundation was formed about a year ago last spring, but it has not performed any function as yet.

Mr. GUARINI. No options——

Mr. MACNAUGHTON. It has received the option and the first year's contribution is due sometime before the end of this year.

Mr. GUARINI. So it has been given the options?

Mr. MACNAUGHTON. It has.

Mr. GUARINI. It has not?

Mr. MACNAUGHTON. It has received the option but has not exercised it, no.

Mr. GUARINI. The one question that would come to mind is that the foundation would be able to sell the stock option whenever it wanted to, or could it sell the stock whenever it wanted to?

How would that work out?

Mr. MACNAUGHTON. The foundation has the privilege of exercising the option at any time it wants to. To the extent that it will have the funds to do so, if it decides in the first year—well, the first year is a good example.

When the option was granted a year ago, the HCA stock was probably worth somewhere in the neighborhood of $28 or $29 per share and currently it is worth—there has been a split, but on the equivalent terms, it would be worth somewhere in the area of $68 or $69 a share.

So that if it chose, it could exercise a substantial amount of that option but it wouldn't have enough funds to exercise the full million share option.

Mr. GUARINI. Would they be able to sell it?

Mr. MacNaughton. If they chose, they could sell the stock after exercising the option, or——

Mr. Guarini. Or sell the option?

Mr. MacNaughton. Or one of the possibilities that exists for HCA, we believe that under present law the foundation would have the right to exercise the option or to sell the option to another foundation which in turn could exercise the option and do whatever they choose to do with the stock, and HCA would still be entitled to a charitable deduction at that time.

We have asked IRS for a ruling as to whether or not that would be OK and we suspect that it is allowable in our own opinion. But it is an expensive way, Mr. Congressman, for the foundation because they have to do through the expense of financing such a transaction.

Mr. Guarini. Then they should not be able to, from what you say, sell the option on the marketplace but they could sell the option to another foundation?

Mr. MacNaughton. It is completely transferrable and may be sold to anyone including another foundation.

Mr. Guarini. That foundation in turn could sell it to the marketplace?

Mr. MacNaughton. Yes. We think that that is legal. Under the present law it is legal, we feel.

Mr. Guarini. So that I know for the record, you say that for the record?

Mr. MacNaughton. Yes.

Mr. Guarini. I have additional questions, but first I will go to Mr. Duncan.

Mr. Duncan. Thank you, Mr. Chairman.

I would like to join the Chairman in welcoming you, Mr. MacNaughton, to the committee, and also our former Chairman, Wilbur Mills.

We are always thinking about the budgetary problems on the Hill. I was wondering, in light of our budgetary problem if you have any idea as to the revenue impact of the proposal?

Mr. MacNaughton. Yes, Mr. Duncan, we think that the proposal, revenuewise, is neutral. We think that it would not cost Treasury anything and would not cause HCA any problems in that way.

The only one that would suffer, as we were just discussing, is if it were to be done under present law, it would cost the foundation something to finance such a transaction as Mr. Guarini just described. It seemed to us that it would be better to clarify the law and to remove this impediment so that the full benefit of the contributions by HCA to the foundation could be used for charitable contributions rather than to finance such an arrangement.

Mr. Duncan. In your testimony you explained why the corporation could not give $30 million in cash in a single contribution. I think I understand that.

Did you ever consider giving just stock instead of the option or perhaps just making the annual contribution?

Mr. MacNaughton. Yes. We did think of giving stock but in doing so, we would run into many of the same problems that we ran into in giving cash.

Giving a million shares of HCA stock at one time would dilute those shares already outstanding and might possibly violate our corporate fiduciary responsibility to HCA shareholders.

In addition, Tennesee law forbids a corporation to give away its stock. It must be sold. Even if you sell it for only a dollar a share, it still must be sold under the law. But the Federal rules, under the Federal rules we can't sell shares to the foundation for any price, so we are back in the catch-22 I described in my statement.

But the principal reason for developing this plan is that we see it as a unique way to allow the foundation to share in the company's growth. We couldn't give the foundation the stock and the foundation doesn't have the money to buy it, but by granting the stock option the price is frozen at the time that the option is granted and that allows the foundation to share as HCA grows without the foundation having spent 1 cent until it exercises the option at a price that could at the time it is exercised be as much as 10 years old.

Mr. DUNCAN. I wonder if you could tell us, I would like to know, what is the purpose of your foundation? What do you do with your foundation?

Mr. MACNAUGHTON. The primary purposes of the foundation are to make charitable gifts in medical education and research, and for medical training and for related efforts in the health care field.

Mr. DUNCAN. Thank you very much, sir.

Thank you, Mr. Chairman.

Mr. GUARINI. Thank you, Mr. Duncan.

Mr. Thomas.

Mr. THOMAS. Thank you, Mr. Chairman.

In your testimony on page 5, Mr. MacNaughton, both you and Chairman Mills addressed the committee, whether you confirm or are not confirming the sale procedure that you outlined as being legal, did the IRS approve that?

Mr. MILLS. Clearly the sale is legal. But whether there is a charitable deduction allowable if it is sold is what we have asked the IRS to rule on. There is just no way we can give you a definite answer, Mr. Thomas, about that.

Mr. THOMAS. It is in the hopper?

Mr. MILLS. It is in the process, yes.

Mr. THOMAS. You propose to give the foundation a stock option on stock amounting to about $30 million at the time that it is done and over a 10-year period they have the opportunity of exercising the option. As a means of providing the wherewithal for the foundation to exercise its option, you are going to provide $3 million a year to the foundation.

So the foundation is a functioning foundation. It has money in the till, and it then has to respond to the laws dealing with foundations and pay out 5 percent. It is going to have overhead in terms of directors and the rest.

So even with my poor math, at the end of 10 years, if you give them the $30 million over the 10 years, they are going to have less money. They won't have the $30 million, or do you anticipate that they will be able to invest a portion of it and come out ahead?

How do you anticipate the $30 million being treated over the 10 years?

Mr. MacNaughton. You are quite right in everything, Mr. Thomas. The option has already been granted. It was granted a year ago. It cannot under the present law be exercised, but it has been granted and the value of it at the time of the grant was $30 million, 1 million shares of HCA stock, which at that time was worth $30 million.

We anticipate making $3 million in contributions each year for a period of 10 years, at the end of which time and during which time the foundation itself will have the opportunity of either keeping the cash—the foundation would be foolish if the price goes below $30 if they just didn't keep the cash and get its house in order so that it could be a charitable foundation within its means at any time during this period of time.

If it were today, for example, and they chose to exercise today, it would be a fairly large amount because of what happened to the HCA stock in the past year. But nevertheless, they would not make their plans based on what happened in 1 year of the stock. They would have to make plans over a longer period of time than that.

Mr. Thomas. Is the optional 1-year option within a 10-year timeframe?

Mr. MacNaughton. No. They can exercise part or all at any time during that 10 years.

Mr. Thomas. Within the 10 years?

Mr. MacNaughton. Yes.

Mr. Thomas. Obviously it would be foolish of the directors of the foundation to purchase the stock if it fell below the original price at which time the option was created.

Even if it were greater than the option price, it would be possible to exercise a portion or all of the option in a way in which the business activities of the corporation would be benefited far more than the foundation, if you understand the direction I am going.

So my assumption is that you have been very careful in terms of structuring the board of directors, its legal counsel, and investment counsel to be totally separate, with no relationship whatever, to the corporation.

Mr. MacNaughton. Except that some members of the foundation board will also be officers of the corporation.

Mr. Thomas. Is that required?

Mr. MacNaughton. Under the charter it is required.

Mr. Thomas. Do you understand my concern, then?

Mr. MacNaughton. Yes, I do understand your concern, but I have an even greater concern and that is if it were the other way, I am afraid the donor would have the concern that its purpose in setting up that foundation would not be met, and those purposes should be met. I think the best way to see that they are met is to have a majority of the members of the foundation also being members of the corporation.

Wilbur, would you like to add to that?

Mr. Mills. I was just going to say that when we looked at this situation in 1969, we found some developments that we thought were entirely contrary to the purpose for which the foundation had been set up.

In those instances, the people who had set up the foundation were no longer in control. The boards were dominated by people other than the founders of the foundation.

For example: To use just one situation, the Ford Foundation was under a lot of criticism at that time. Henry Ford II was on the board but he was the only representative of the Ford family, as I recall, that was on the board. People other than those who had Henry Ford's viewpoint prevailed.

I often wonder just how many times Edsal and Henry, Senior, would turn over in their graves on hearing of some of the things the foundation was charged with doing. I think there is a legitimate reason for a creator of a foundation to stay in control to the extent of seeing that his objectives are carried out by the foundation.

Mr. THOMAS. I understand that concern. If the foundation were funded and then the money was used for the purpose for which the foundation was created, I can understand.

I would hope you appreciate my concern if there is a relationship which may or may not occur over a 10-year period which could affect the corporation if the foundation exercised an option or not. That is a little bit different as an arrangement, obviously, currently not allowed under the law.

That would concern me in terms of the unique and special relationship between the foundation and its potential impact with the corporation.

I am not clear in terms of the option selling procedure. Would you envision the law being changed to get you out of the catch-22 situation to allow the purchase or exercise of the option to also allow the selling of the option at any time during that 10-year period?

Mr. MACNAUGHTON. We would propose that the change in the law be limited to those options of stock that is traded on a reputable market, a public market. We think that that gets away from the machinations that were flagrant in the abuses of the 1960's with respect to hiking the price of stock or, in some cases, reducing the price of the stock for the benefit of the donor.

Mr. MILLS. If I may add, Mr. Thomas, we were concerned about unlisted stocks, family-owned situations, but we applied the rule across the board. Frankly, I think we went too far. We went further than intended or further than there was justification in going at that time.

There was no criticism of the foundations that had stocks listed on an exchange.

Mr. THOMAS. That is right.

Mr. MacNaughton, I want to congratulate you; this is a creative concept that could reap the foundation tremendous rewards.

At the end of that 10 years, if your stock continues to go up and split the way it is going, my concern would be, though, it is novel and creative and you are requesting a change in the law in fact to allow it to occur, except for the exchange arrangement which the IRS may or may not say is legal.

So let me say that there may be some reaction from some of the members in terms of perhaps a requirement that certain things be done in order for us to feel comfortable about the procedure, and I am willing to work with you about what may or may not be acceptable to you in terms of restraints that might be placed on the foundation for the time period in which the option is available.

Mr. MacNaughton. I understand.

Mr. Thomas. I don't want to preclude automatically this kind of thinking because it could be a tremendous asset to an area or foundation working in the medical research area that is so desperately needed.

Mr. MacNaughton. We will be happy to discuss any possibilities with you, Mr. Thomas.

Mr. Thomas. Thank you, Mr. Chairman.

Mr. Guarini. Part of our responsibility, of course, is to assure that any change we make not harm the foundation.

Is the foundation running a risk in any way with that stock option plan?

Mr. MacNaughton. We don't see how the foundation could lose no matter what happens to the value of HCA stock. If the stock goes up or even if it stays where it is, the foundation will inherit a bounty for its charitable purposes.

As we said earlier, if the market, if the price of the stock should fall below the $31, they would be crazy to exercise the option. But as I say in my statement, however, if further restrictions were required, we would have no objection to restrictions that would say that the foundation could not exercise an option which would be to its own detriment.

In that 10 years, they will wind up with 30 million in contributions, which is a worthwhile effort, whether the stock goes up or down.

Mr. Guarini. Thank you. I understand the reasons for restrictions and we are concerned about any change that may undo the restrictions.

Are you concerned that a change in the law such as you suggest would open the abuses that we had before the 1969 changes?

Mr. MacNaughton. No, not at all. If we had any question in our minds at all that what we were proposing would in any way make those abuses come back to life, we would not make the proposal. That would not be in your interests, but it would be no more in our interests than yours.

We are convinced that by limiting this to stock traded on the public exchange that the problem would not give rise to the return of any of the abuses.

Mr. Guarini. Would there be a limitation put on by other laws besides Tennessee laws that would prevent this from occurring?

Your idea is a very creative and novel idea. We particularly thank you for bringing this suggestion, Mr. Mills, to the Ways and Means Committee because it could open up a new area for health care research and technology which all of us would benefit from.

Is there any State regulations that you think would stand in the way of accomplishing this?

Mr. MacNaughton. None that we know of.

Maybe, Mr. Mills, you might respond.

Mr. Mills. I do not know of any.

Mr. Guarini. Thank you, Mr. MacNaughton and Mr. Mills, not only for the service you have given to this country but particularly for the new ideas you brought to us today.

Mr. MacNaughton. Thank you very much.

Mr. Mills. Thank you, Mr. Chairman.

[The following was subsequently received:]

Committee on Ways and Means,
Subcommittee on Oversight,
Washington, D.C., July 15, 1983.

Mr. Donald MacNaughton,
Chairman, Hospital Corporation of America.
Washington, D.C.

Dear Mr. MacNaughton: Thank you for your participation in the Oversight Subcommittee's recent hearings concerning private foundations. In order to complete our hearing record, your response to the following questions would be appreciated.

(1) Under your plan, can the Foundation sell the stock option to an unrelated third party other than another foundation? If not, why?

(2) How many HCA company directors, officers, shareholders, or employees hold positions on the board of the Foundation? Will the foundation have legal and investment counsel that are separate and independent from the company?

(3) What is the value of the stock option given to the Foundation?

(4) Has the Company taken a charitable deduction for the donation of the stock option to the Foundation? If not, why?

I would appreciate your response by Friday, August 5, 1983. If you have any questions, please contact Bill Kirk, Staff Director, or Rusty Guritz, Assistant Counsel, of the Subcommittee Staff at 225-5522.

Thank you for your assistance.

Sincerely,

Charles B. Rangel,
Chairman.

Hospital Corporation of America,
Nashville, Tenn., August 4, 1984.

Hon. Charles B. Rangel,
Chairman, Subcommittee on Oversight,
Washington, D.C.

Dear Congressman Rangel: It is with pleasure that I enclose my responses to the inquiries contained in your letter of July 15, 1983. I trust you will find them satisfactory and fully responsive.

May I draw your attention to the issue raised in your second question. I continue to be firmly of the opinion that the exemplary character and reputation of those members of HCA's Board of Directors who are also senior officers of other major corporations ensures that no decision detrimental to our Foundation would be made knowingly. However, I understand that your Subcommittee must be concerned with all private foundations and, therefore, I endorse the concept that private foundations should be guided in matters of investment policy—including the exercise of a stock option—by a professional investment advisor that is absolutely separate and independent from the sponsoring corporation.

In addition, may I share with you a recent and relevant decision of the Internal Revenue Service. As you may recall, I testified that the requested change in law—to permit a foundation to exercise a stock option granted by a substantial contributor—would, in our opinion, have no impact on Treasury receipts. This was true, we believed, because a charitable deduction would be permitted when the stock option was exercised either by our Foundation or by another charitable organization following a transfer of the option by our Foundation. The only difference, as I testified, would be the substantial costs incurred by our Foundation in transferring the option to another charitable organization and the subsequent loss of those monies to our charitable goals.

The Internal Revenue Service, at our request, has now ruled in our favor. A charitable deduction will be permitted regardless of which charity exercises the option. Consequently, I can now state categorically that the suggested change in law will not have any adverse revenue impact on the federal budget.

Once again, I would like to thank you and the Members of your subcommittee for the opportunity to bring this problem to your attention.

Very truly yours,

DONALD S. MACNAUGHTON,
Chairman of the Board.

Enclosure.

RESPONSES OF DONALD MACNAUGHTON, CHAIRMAN OF THE BOARD OF HOSPITAL CORPORATION, TO QUESTIONS POSED BY THE HONORABLE CHARLES B. RANGEL, CHAIRMAN, OVERSIGHT SUBCOMMITTEE, WAYS AND MEANS COMMITTEE, U.S. HOUSE OF REPRESENTATIVES

Question (1). Under your plan, can the Foundation sell the stock option to an unrelated third party other than another foundation?

Response. Yes, it is now fully transferable. However, at the time the option was originally granted, it contained a stipulation that the option was not transferable unless the I.R.S. ruled that the exercise of the option by the HCA Foundation would constitute an act of "self-dealing" as defined in section 4941(d) of the Internal Revenue Code.

By statutory definition, the HCA corporation was a substantial contributor to the Foundation and thus the I.R.S. was compelled to rule, and did rule, that the exercise of the option by HCA Foundation would be an act of "self-dealing." Consequently, under the terms of the option agreement, the HCA Foundation "may transfer [the] Option in whole or in part to one or more transferees. . . ."

Question (2). How many HCA company directors, officers, shareholders, or employees hold positions on the board of the Foundation? Will the foundation have legal and investment counsel that are separate and independent from the company?

Response. At the present time, there are five Directors of the HCA Foundation, all of whom are either Officers, Directors or shareholders of the sponsoring corporation. Two additional members have been proposed to be added to the Foundation board who are independent "outside" Directors of HCA. They are either present or former Chief Executive Officers of other major corporations, including Wells Fargo & Company and E.I. Dupont & Company, Inc.

The Foundation was established on the basis of legal advice and legal documents rendered by an independent law firm. At the present time, the assets of the Foundation do not warrant the retention of a professional investment advisor.

I believe I understand the basis underlying this question. However, I am compelled to express my complete confidence and trust in the Directors of our Foundation. Although they may serve on our corporate board as well as on the boards of other corporations, I cannot conceive of a circumstance where their integrity or fiduciary duty to the HCA Foundation would be compromised.

Nevertheless, I also understand that you have the responsibility for the oversight of all private foundations, and that there may be a need for guidelines to insure that all private foundations act in accordance with the charitable purposes and principals set forth in their charters. Accordingly, I endorse the concept requiring private foundations to have professional investment advisors that are separate and independent of the sponsoring corporation in order that the foundation directors have their fiduciary relationship preserved and their investment advice enhanced.

Question (3). What is the value of the stock option given to the Foundation?

Response. I assume the question is directed at the value of the option at the time it was granted as well as the present value and I will answer accordingly. It may be helpful to first distinguish the type of stock option that we granted to the HCA Foundation from stock options that are commonly created solely to be listed and traded on a public exchange like the Chicago Board Options Exchange. Those options are routinely sold at a premium and traded during the life of the option contract, which normally does not exceed 90 days.

The stock option granted to the HCA Foundation is analogous to a non-Qualified Stock Option as defined in the Internal Revenue Code and regulations. Although generally granted by an employer to an employee, these options are usually not transferable or publicly traded, and extend for a much longer period of time—often ten years.

At the time HCA granted the option to the HCA Foundation it was not transferable by the Foundation. The price of the stock underlying the option was the fair market value of the stock on the day it was granted. Thus, the option had no real value. I must point out that the ten year life of this option may have created some value at the time of the grant, but there is little purpose in establishing such value. A recent I.R.S. ruling, favorable to HCA states that a charitable deduction would be allowed at the time the option is exercised, rather than when it was granted. The amount of the deduction would be the difference between the option price and the fair market value of the stock at the time it is exercised. Consequently, the value of the option at the time it is granted (as opposed to the value of the underlying stock at that time) is irrelevant. The option price which was written into the agreement on the day the option was granted was the value on the New York Stock Exchange of HCA stock on that date—viz. $31.8125 for each share or nearly $32 million for all the shares available in the option. In January the stock split 4 for 3 so that the Foundation now holds options on 1,333,333 shares at an exercise price of almost $24 per share. At the present time, the shares are worth approximately $68 million and thus, if the Foundation were permitted to exercise the option, it would have assets of approximately $36 million.

However, if the law is not amended to permit the Foundation to exercise the option, it will have to sell the option at a substantial discount because of the difficulty in trading such a large block of stock. In addition, the Foundation will incur significant legal, accounting and brokerage fees to arrange the sale. Our point is simply that these discounts, fees and costs are unnecessary and could be used so much more productively by the HCA Foundation in medical and scientific research.

Question (4). Has the Company taken a charitable deduction for the donation of the stock option to the Foundation? If not, why?

Response. No, HCA has not taken a charitable deduction for the donation of the stock option. At the time the option was pledged to the Foundation it was non-transferable and the option price contained in the agreement was exactly equal to the fair market value of the stock on that day. Therefore the option itself had little or no real value at that time. Moreover, the I.R.S. ruled in 1975, and again in 1982, that a charitable deduction would not be allowed for the grant of an option to purchase property until the option was exercised. The I.R.S. views the transfer of an option as an asset without a readily ascertainable fair market value. At the time of exercise there is a value that can be easily determined and a charitable deduction is then available.

Recently, HCA requested the I.R.S. to rule on its specific situation and requested that it be entitled to a charitable deduction upon the exercise of the option by an unrelated charitable organization. On July 1, 1983 the I.R.S. ruled favorably that HCA ". . . will be entitled to a charitable contribution deduction in the manner and to the extent provided by section 170 of the Code for the year in which the unrelated charitable organization exercises the option. The amount of the contribution is the excess of the fair market value of the stock on the date the option is exercised over the exercise price."

Naturally we are pleased with this favorable ruling but we are very much concerned that our Foundation will receive substantially less from the exercise of the option if it were compelled to sell the option to another charity at a discount in addition to incurring legal, accounting and brokerage fees. While it is difficult to accurately predict the amount of the costs and the discount, we estimate that if the HCA Foundation were compelled to sell the option at a discount, it would receive 5 percent to 10 percent less than if it were able to exercise the option directly over a period of years. At today's value, that would mean up to $4 million would be lost for medical research.

Mr. GUARINI. I would like to call Mr. Edley, president of the United Negro College Fund.

We welcome you, Mr. Edley.

STATEMENT OF CHRISTOPHER F. EDLEY, PRESIDENT, UNITED NEGRO COLLEGE FUND, INC.

Mr. EDLEY. Mr. Chairman and members, it is nice to come after one of our great benefactors, both in his present position and past position, Don MacNaughton.

Mr. Chairman and members of the committee, I realize that I am either last or near the end of the day and I will try to be brief.

Mr. GUARINI. You are the clean-up hitter, as they say.

Mr. EDLEY. I have submitted my testimony and I will not read the entire statement.

I will alert you I intend to correct a couple of factual errors in my submitted statement by submission at a later point.

Mr. GUARINI. Your report will be put into the record, of course.

Mr. EDLEY. Thank you.

As president of the United Negro College Fund, I am the full-time executive of that organization and I am here to testify with regard to the importance of America's foundations in the history of black higher education in this country, and specifically the importance of the Nation's foundations to the United Negro College Fund.

I hope you will not consider it in any way disrespectful to say that long before our Congress developed the sensitivity and interest that are now evident, many decades ago the Nation's foundations came to the rescue of blacks struggling to achieve a higher education.

The college fund itself, which was created in 1944, was the product of two grants, one from the Julius Rosenwald Fund of Chicago and the General Education Board of the Rockefeller Foundation. Without those farsighted grants, we would not exist today.

In the teens and 1920's and 1930's, many of the black elementary and secondary schools in the South were founded under matching grant incentives from America's foundations. That is foundations such as the two I mentioned and the Peabody and Jeanes Funds, go down in the annals of black history as truly noble contributions to the progress of minorities in this society.

So it is that the very establishment and nurturing of black education and higher education in this country was closely allied with the evolution and progress of America's foundations.

Since 1944 the United Negro College Fund has received approximately $300 million in gifts. Fully one-quarter of those funds have come from foundations and that continues up to the present time. Many are generous enough to say that without the United Negro College Fund, most of the Nation's predominantly black private colleges would not exist.

If true, then we can surely say that without the private foundations, without the foundations of the Nation, our private colleges would not exist. We submit to you that that is a noble accomplishment.

I would like to mention a few of the foundations and the types of programs that have meant so much to us.

Recently, within the past 6 years, the Ford Foundation has granted some $3.5 million for the support of our institutions, including a $1 million grant on a matching basis, to stimulate other foundations and contributors to make donations to the United Negro College Fund.

The Kresge Foundation has provided $6 million for desperately needed renovation and construction programs at UNCF institutions and these programs are now some 2½ years into execution, making a material difference.

We raised some $60 million, in excess of $60 million, in fact, in our campaign launched in 1978 and which continued for 3 years. Of that $60 million, approximately half came from the Nation's foundations. Now I am talking no more about history; I am talking about reality.

Whatever the abuses were they were corrected in 1969, and however laudable Congress's action, one of the consequences was that we lost a lot of foundations that supported the United Negro College Fund. But I will accept that on balance, because we continue to benefit and your work obviously will continue to make it possible for these foundations to exist. But we do have a personal stake in the foundations and how they thrive.

To mention a few other grants that point this out, we have received a $3.7 million grant from the W. K. Kellogg Foundation, and a $1.5 million grant from the Andrew W. Mellon Foundation. These grants are specific and restricted for purposes that will improve the quality of our schools.

The United Negro College Fund receives 1,100 contributions a year from America's foundations, big gifts and small gifts. That number of gifts has not increased significantly during the past 5 years.

Since 90 percent of our students receive some form of scholarship aid, private and Government scholarship assistance, we have a keen concern about the amount of money that the Nation's foundations provide for the higher education of needy minority youngsters.

We would love to see a greater response to the President's call for the private initiatives to make contributions. One such response was from the Annenberg Fund in 1982 and over the past 3 years, the Annenberg Fund has given some $2.1 million to the United Negro College Fund to provide undergraduate and graduate fellowships for deserving youngsters.

A newer program is the UNCF distinguished scholars program established in 1981 by the John D. and Katherine T. MacArthur Foundation. This 5-year program has two phases. In phase 1 scholars drawn from UNCF faculty are supported for 1 year to pursue research in their particular disciplines. In phase 2, scholars from the general public are invited to serve an academic year in residence at a UNCF institution. That type of innovative grant, which is common in some of the Nation's most prestigious institutions, is very rare at our predominantly black colleges and universities.

In my paper submitted, I go on and recount other significant grants and actions by the Nation's foundations.

Am I completely happy with what the foundations provide? No.
Can we do without what they do? No.
Would I like to see them do more? Yes.

But we would urge the committee as you exercise your oversight to bear in mind that there are many causes in America such as ours that have a dependency on these foundations.

We know that our case is not one that appeals to all foundations, even some who have general purposes and are not restricted by the foundations own guidelines. But we also know that as long as those foundations exist that we have a fair chance to persuade them of the strength of our cause and to elicit their support. And I would rather have them here with the challenge of having them support our cause than for them not to exist.

That concludes my remarks, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF CHRISTOPHER F. EDLEY, PRESIDENT, UNITED NEGRO COLLEGE FUND, INC.

I am Christopher F. Edley, President of the United Negro College Fund. I speak as an official representative of the private, traditionally black colleges and universities. The United Negro College Fund is America's first united educational chest. It is the official fund-raising body for forty-two private black senior colleges in the country. These colleges and universities currently enroll more than 45,000 students studying towards baccalaureate and advanced degrees, and several thousands more students who are involved in non-credit continuing education courses and programs.

These institutions represent a strategically important segment of American higher education. Although the predominantly black colleges and universities comprise less than five percent of American institutions of higher education, and their enrollments comprise less than three percent of all college students, historically black institutions of higher education enroll 18 percent of all black college students.

The United Negro College Fund was founded in 1944 on the principal initiative of Dr. Frederick D. Patterson, partly with funds contributed by two foundations, the Julius Rosenwald Fund of Chicago and the General Education Board of The Rockefeller Foundation. Since that time, the College Fund has enjoyed a close and what we regard as a mutually rewarding relationship with foundations. Since 1944, UNCF has raised $300 million, at least one quarter of which came from foundations. Last year, in 1982, the 1,100 foundation gifts we received accounted for 15 percent of our total income.

Many years before Congress evidenced concern for minorities, as it does now, some foundations made rich contributions which ensconced them in black history. In the teens and '20's and '30's many of the black elementary and secondary schools in the South were founded under matching grant incentives from America's foundations. That is foundations such as the two I mentioned and The Peabody and Jeanes Funds go down in the annals of black history as truly noble contributions to the progress of minorities in this society.

I appear before you today to speak briefly on the impact foundation contributions have had on the growth of the College Fund.

In 1982, according to the American Association of Fund-Raising Counsel, contributions from foundations came to $3.15 billion or 5.2 percent of the total giving to philanthropic institutions. Although this amount is relatively small when compared to the $48.69 billion contributed by individuals, it has been the experience of the College Fund that foundation donations have had the most profound impact on our progress. Time and again, foundation dollars have funded our most experimental and innovative programs; have sustained the general operating costs of our institutions and have provided scholarship funds to thousands of young people attending UNCF institutions.

From the $50,000 contributed to UNCF in 1944 by its two original foundation donors to the $3.8 million received in 1982, foundation grants have had a disproportionate impact on the growth of UNCF. It has often been the matching or challenge grant of the foundation, such as The Ford Foundation's Capital Resources Development Program grant of $3.5 million of which its $1 million matching grant served as a catalyst to spur larger corporate and individual contributions. Foundations have made record-breaking grants to UNCF such as the $6 million contribution of The Kresge Foundation to the Capital Resources Development Program in support of desperately needed renovation and contributions to our Capital Resources Development Program accounted for almost 50 percent of the $60 million UNCF raised.

Foundation have helped UNCF improve the opportunities a talented black youngster has to enter the professions. For example, a UNCF flagship program is our premedical Summer Institute. Begun in 1971 with funds provided by the W. K. Kellogg Foundation which subsequently made a grant of $3.7 million to our Capital Resources Development Program and later substantially supported by The Andrew W. Mellon Foundation with grants totalling $1.5 million, this program has helped hundreds of students enter medical and dental schools or graduate programs in the sciences. As the quality of health care for the black Americans is still substantially below average, these foundation grants are having an impact on both the careers of UNCF students and the quality of health care provided to twelve percent of the American population.

While some foundations have gone out of business since 1969, foundations have helped improve public awareness of the historic missions and unique contributions of UNCF institutions. In 1978, The Piton Foundation of Colorado made a grant in support of "Forty-One Places To Expand Your Mind," a publication which was subsequently distributed to 50,000 high school guidance counselors and schools across the country. This publication helped inform thousands of youngsters that it is possible to obtain a reasonably priced education at a historically black institution.

Since 90 percent of our students receive scholarship aid and the median family income of our students is $13,700, almost half the national average, scholarship funds are an absolute necessity. Each year, the Education Service Department of UNCF administers an average of $1.2 million in 90 separate scholarship programs. Community foundations have played an especially pivotal role in making scholarship grants. Since 1973, The Columbus Foundation has been making scholarship grants to Ohio residents, as has The Cleveland Foundation when it also began awarding scholarships to students from Ohio in 1979.

Foundation support has been instrumental in helping students prepare for careers in demand in the labor market such as business administration. Since 1969, the Helena Rubinstein Foundation has provided aid for women preparing for business careers. Another new and very promising foundation-funded program is The Twenty-First Century Scholars Program established by The Annenberg Fund in 1982. Thus far, The Annenberg Fund has dispersed $2.1 million in grants over a three-year period. This program provides awards to academically superior UNCF undergraduates and graduating seniors. During the next ten years, this program will support 20 to 30 students per year.

Foundation support has also had a significant effect on faculty enrichment at UNCF. Lilly Endowment, Inc., a strong supporter of the College Fund since the beginning, currently underwrites the UNCF Faculty Development Program. The Endowment provides $300,000 in financial assistance to faculty for advanced study leading to the doctorate. The percentage of faculty holding doctorates has increased from 31 percent in 1970 to 43 percent in 1982. Over the years, Lilly Endowment, Inc. has made almost $4 million in grants to UNCF.

A newer program is the UNCF Distinguished Scholars Program established in 1981 by the John D. and Catherine T. MacArthur Foundation. This five-year, $2.5 million program has two phases. In phase one, scholars drawn from UNCF faculty are supported for one year to pursue research in their particular disciplines. In phase two scholars from the general public are invited to serve an academic year in residence at a UNCF institution. While there, they share their experience with students, faculty, and the local community. This program allows scholars at UNCF colleges to pursue original research and promotes the opportunity for intellectual exchange between distinguished scholars and UNCF college communities. Clearly, programs such as the Lilly-funded UNCF Faculty Development Program and the MacArthur Program enhance the effectiveness of the faculty and enrich the quality of education on UNCF campuses.

Foundations have played a vital role in strengthening the curriculum at UNCF colleges. Traditionally, UNCF institutions have provided their students with a solid grounding in the liberal arts and sciences. In addition, each institution is continually developing new courses and programs to prepare students for new career opportunities in the health professions, engineering and computer science.

A foundation program in operation since 1974 which has been credited with helping increase the number of UNCF chemistry students admitted to major graduate and professional schools by 57 percent during the late 1970s and early 1980s is the Visiting Lecture Series in Chemistry, sponsored by The Camille and Henry Dreyfus Foundation. Their annual grant supports visits by 20 practicing chemists to as many institutions. Scientists come from such organizations as Corning Glass Works, Eastman Kodak Company, Polaroid Corporation and Howard University. The chemists conduct special seminars and lectures for chemistry majors and give a public address on a topic of general interest.

Along with supporting general operating funds, student support, faculty enrichment, curriculum enhancement, public awareness and building and construction, some foundations have structured their contributions as endowment. In 1970, The Charles A. Dana Foundation made a grant of $250,000 with provisions that income from principal to be used to support The Charles A. Dana Faculty Improvement Fund. The grant, to cover a ten-year period, was to help UNCF faculty pursue graduate and doctoral study. Subsequent grants which will eventually total over $1 million from the Foundation have increased the life of the grant to 1990, under the original conditions. Since the beginning of the program, over 70 UNCF faculty members have been Dana Fellows and 12 have earned their degrees.

As I have tried to demonstrate, many foundations have worked for the United Negro College Fund to make a significant contribution to the education of American citizens. The results of this cooperative effort can be seen in the contributions of graudates fo UNCF colleges—in those who have distinguished themselves as UN ambassadors, nobel prize winners, opera singers, cancer researchers, and, in the thousands of doctors, business managers and educators who serve our society. As UNCF prepares to enter its fourth decade of service, we look forward to continuing our special partnership with foundations in supporting the growing UNCF membership.

Mr. GUARINI. Thank you for a very fine statement.

Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Edley.

I want to compliment you on a statement very well prepared and presented and also on the good work that you do through the United Negro College Fund.

Let me ask you have you had any colleges closed here in the past year for financial reasons?

Mr. EDLEY. No, the United Negro College Fund has been fortunate in that no member institution has closed, but we are on notice that one of our 42 member institutions may not be able to open its doors in September unless it receives additional financial help on an emergency basis.

I always say that at any given time, three of our institutions are on the ropes. It is no surprise to anyone that our institutions have existed through the years on a hand-to-mouth basis and the surprising thing is that we have been able to maintain such excellent quality despite the shortage of dollars, and that is due to the dedication of the faculty and administrators and the supporters of the institutions. But we are in dire financial straits.

Mr. DUNCAN. Do you make special efforts toward raising funds for those particular colleges that are in financial problems or on the ropes, as you say.

Mr. EDLEY. We are not under the rules of the college fund permitted to do so. Our institutions share on a formula basis so that they are all equal in that sense aside from making statements like the one that I just made and hoping that, one, you won't ask me to name the college and, two, one of these foundations listening will come and say "How can we help?"

That is the only way I can help these specific institutions.

Mr. DUNCAN. I will talk to you after the meeting is over. Maybe we can get them to come around and help.

Mr. EDLEY. Thank you, Mr. Duncan.

Mr. GUARINI. I would congratulate you on the good work that you and your association does and really give you encouragement for keeping up the good work because it is such an important part of the educating of our people and the services that you perform are very essential to keeping our country strong.

Do you think that the foundation, Mr. Edley, should give a larger than the 5-percent that is in the law in this day of high interest rates and higher appreciations of its money? Do you have any opinion as to whether or not the 5 percent figure is a fair figure under today's circumstances?

Mr. EDLEY. I think that it is a fair figure. I know that some of the wisdom would say force more money out of them which will end up in their going out of existence but in the picture that I have painted to you, going back to the teens and the turn of the century, the continued existence of these foundations is of great importance.

And, as we say, I would rather have $5 million a year indefinitely from foundations than to have $25,000 or $30,000 next year and the foundation spend cut.

Mr. GUARINI. You would rather have it be there.

Mr. EDLEY. That is right.

Mr. GUARINI. Did you find that the foundations restrict the moneys, the use of the moneys, inordinately or do you not have trouble? Because I know many colleges receive money from foundations and that may be for certain and restricted kinds of gifts that they get, and they can really put it to the purpose of what the policymakers of the institution would want, and I am wondering whether or not you have any problems with foundations on the restriction of the gifts.

Mr. EDLEY. Yes, I do. I have grave problems with regard to that. I might say that I was a program officer in charge of the Government and law program at the Ford Foundation for 10 years before going to my present position 10 years ago, and I think that there was a temptation by all of us to play God as foundation executives and to assume that we know more than the people who are going to receive the money and that there was a need for us to impose certain restrictions to make sure that the money was used and all of that was fair and good.

The tendency to believe on the part of many foundations that anything that provides general support is bad and smells is most unfortunate, and I know in my own experience in the cycle initially I was broadminded. After 3 or 4 years, I thought that I was good at the God-making business but after 10 years of experience in the foundations, I concluded that the God-making business wasn't the best and that the general support grants and recognizing the established organizations was important.

We have a very serious problem with our institutions where foundations desire to give us cake and ice cream when we need bread, and after this testimony, I probably won't get either.

Mr. GUARINI. Just mention the word.

Mr. EDLEY. So you know I think that anything can be done, we have a program called the College Endowment Funding program which is designed to take specific dollars and convert them to endowments that over the years, 10, 15, or 20 years hence will become general purpose endowment funds, but it isn't just the foundations. It is also the corporations that are moving in the direction of more and more restricted grants and it is very difficult.

If you have a moment, it is also a bit unfair because someone will come along, corporation or foundation donor, with the desire, let us say, to train a marine biologist, and all they want to do is put money into the training of the marine biologist, but someone took this student out of a third or fourth-rate high school, provided them with the scholarship to come to college and gave them remedial work as freshmen so that they could reach the level of doing college level work effectively, and finally they reached the point where they can be anything that they want to be, and someone comes along and provides for marine biology without recognizing their obligation to assist in the basic preparation of that student that led the student to that point where he was intellectually able to make that choice.

Mr. GUARINI. Well, thank you, Mr. Edley. Are there any other questions?

[No response.]

Mr. GUARINI. We thank you for the benefit of your testimony, your appearance and your good work.

Mr. EDLEY. Thank you.

Mr. GUARINI. The chair would like to make an announcement, this hearing will continue on Thursday, June 30, beginning at 10 a.m. in this room, 1100, Longworth House Office Building. The hearing is adjourned.

[Whereupon, at 3:20 p.m., the hearing was adjourned, to reconvene at 10 a.m., Thursday, June 30, 1983.]

APPENDIX

89th Congress }
1st Session }
COMMITTEE PRINT

TREASURY DEPARTMENT REPORT
ON
PRIVATE FOUNDATIONS

COMMITTEE ON FINANCE
UNITED STATES SENATE

(THIS REPORT HAS NOT BEEN CONSIDERED BY THE SENATE COMMITTEE ON FINANCE. IT IS BEING PRINTED FOR INFORMATIONAL PURPOSES ONLY)

FEBRUARY 2, 1965

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LETTER OF TRANSMITTAL

THE SECRETARY OF THE TREASURY,
Washington, February 2, 1965.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

Hon. WILBUR C. MILLS,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMEN: I am transmitting herewith the report of the Treasury Department on private foundations. This report responds to requests by the Committee on Finance of the Senate and the Committee on Ways and Means of the House of Representatives that the Treasury Department examine the activities of private foundations for possible tax abuses and report its conclusions and recommendations to the committees. The report contains the results of an extensive study made by the Department pursuant to such requests and contains proposals for correction by legislation of inadequacies of the law disclosed by the study.

Sincerely yours,

DOUGLAS DILLON.

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U.S. TREASURY DEPARTMENT REPORT ON PRIVATE FOUNDATIONS

INTRODUCTION

Because of the importance which this Nation attaches to private philanthropy, the Federal Government has long made generous provision for tax exemptions of charitable[1] organizations and tax deductions for the contributors to such organizations. Since the Federal tax laws in this way encourage and, in substantial measure, finance private charity, it is altogether proper—indeed, it is imperative—for Congress and the Treasury Department periodically to reexamine the character of these laws and their impact upon the persons to which they apply to insure that they do, in fact, promote the values associated with philanthropy and that they do not afford scope for abuse or unwarranted private advantage.

This Report responds to requests by the Committee on Finance of the U.S. Senate and the Committee on Ways and Means of the House of Representatives that the Treasury Department examine the activities of private foundations for tax abuses and report its conclusions and recommendations. Both the Congress and the Treasury Department have investigated these problem areas in the past. A major study resulted in important legislation in 1950, when opportunities for self-dealing and the accumulation of income were restricted and, in addition, the income of feeder organizations and the unrelated business income of certain classes of organizations were subjected to tax. The Revenue Act of 1964 imposed further restrictions on foundations seeking to qualify as recipients of unlimited charitable contributions. However, the major revisions of 1950 have not been comprehensively reviewed since their enactment. In its present study, the Treasury Department has sought to determine whether existing legislation has eliminated the abuses with which it was designed to cope, and whether additional abuses have developed which require correction by legislative action.

In keeping with the congressional requests which prompted it, the scope of this Report is limited to private foundations. The discussion of problems and proposed solutions, thus, is confined to that context. The restriction of the Report to private foundations does not indicate any judgment upon whether or not similar or other types of problems may exist among other classes of exempt organizations. For purposes of this Report, the term "private foundation" designates:

(1) Organizations of the type granted tax exemption by section 501(c)(3) (that is, generally, corporations or trusts formed and

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[1] The terms "charity" and "charitable" are used in their generic sense in this Report, including all philanthropic activities upon which the relevant portion of the Internal Revenue Code of 1954 (sec. 501(c)(3)) confers exemption. Unless otherwise indicated, all statutory references are to the Internal Revenue Code of 1954, as amended.

operated for religious, charitable, scientific, literary, or educational purposes, or for testing for public safety or the prevention of cruelty to children or animals), with the exception of—

(*a*) Organizations which normally receive a substantial part of their support from the general public or governmental bodies;[2]

(*b*) Churches or conventions or associations of churches;

(*c*) Educational organizations with regular faculties, curriculums, and student bodies;[3] and

(*d*) Organizations whose purpose is testing for public safety;[4] and

(2) Nonexempt trusts empowered by their governing instruments to pay or permanently to set aside amounts for certain charitable purposes.

In carrying forward its study, the Treasury Department has conducted an extensive examination of the charactistics and activities of private foundations. It has investigated and evaluated the experience of the Internal Revenue Service and the Department of Justice in the administration of the laws governing the taxation of foundations, their contributors, and related parties. Its study has drawn upon pertinent information assembled in investigations conducted by other groups.[5] It has conducted a special canvass of approximately 1,300 selected foundations. From these and other sources, it has compiled and tabulated a variety of classes of relevant statistical data. It has discussed the area with an Informal Advisory Committee on Foundations appointed by Secretary Dillon.[6] It has, further, considered a broad range of proposals for reform, extending from remedies narrowly tailored to end specific abuses to sweeping recommendations for the elimination or restriction of tax exemptions and deductions for certain classes of foundations.

The Department's investigation has revealed that the preponderant number of private foundations perform their functions without tax abuse. However, its study has also produced evidence of serious faults among a minority of such organizations. Six major classes of problems exist; other problems are also present. While the Internal Revenue Service has taken vigorous action in recent years to improve its administration of the existing laws which govern foundations and their contributors,[7] additional legislative measures appear necessary to resolve these problems.

This Report seeks first to place private foundations in general perspective, by considering the values associated with philanthropy and the part played by private foundations in realizing those values. Against this background, it explores the major problems in detail and presents possible solutions.[8] In a separate part it describes additional problems of less general significance and recommends approaches to deal with them.[9]. Appendixes present tables of relevant statistics and other information.

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[2] Described in sec. 503(b)(3).

[3] Described in sec. 503(b)(2).

[4] While organizations within this minor category are exempt from tax, contributions to them are not deductible; and they would therefore appear to be more closely analogous to business leagues, social welfare organizations, and similar exempt groups than to foundations.

[5] E.g., Subcommittee No. 1, Select Committee on Small Business of the House of Representatives, whose chairman is Representative Wright Patman. The reports of the investigations of this subcommittee, entitled "Tax-Exempt Foundations and Charitable Trusts: Their Impact on Our Economy," have been published in three installments (dated, respectively, Dec. 31, 1962, Oct. 16, 1963, and Mar. 20, 1964) and are hereinafter referred to as the "Patman Reports." A transcript of hearings held by the group in 1964 has been published recently. See "Tax-Exempt Foundations: Their Impact on Small Business," hearings before subcommittee No. 1 on Foundations, 88th Cong., 2d sess., 1964.

[6] This Committee met with Treasury officials on several occasions, and was a valuable source of informed opinion; but the conclusions and recommendations of this Report are those of the Treasury Department, and are, of course, based on facts and views drawn from many additional sources.

[7] Appendix B summarizes the administrative improvements which have been effected by the Internal Revenue Service.

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[8] The Report does not deal with the problem of distinguishing between permissible educational activities of foundations and dissemination of propaganda. The distinction is drawn by existing law. The Internal Revenue Service has been investigating situations of questionable operations and taking the action appropriate under presently applicable rules. This program will continue.

[9] The provisions designed to insure compliance with existing law will have to be reexamined to determine their adequacy to the task of securing compliance with the rules proposed in this Report. The fundamental objective of such provisions should be to make certain that funds which have been committed to charity and for which tax benefits have been granted will in fact be devoted to charitable ends. Also, effective enforcement of the rules recommended here will require the filing of information returns by the organizations to which the rules apply. Since certain private foundations are not now required to file such returns, suitable revisions will have to be made in the relevant provisions of existing law.

SUMMARY OF REPORT

I. An Appraisal of Private Foundations

While private foundations have generally been accorded the same favorable tax treatment granted other philanthropic organizations—exemption from tax and the privilege of receiving donations deductible by the donors—previous legislation has placed several special restrictions upon them. To determine whether additional restrictions are necessary, one must first inquire into the character of the contribution which private foundations make to private philanthropy and the validity of the general criticisms which have been leveled at them.

A. PHILANTHROPIC VALUES AND PRIVATE FOUNDATIONS

Private philanthropy plays a special and vital role in our society. Beyond providing for areas into which government cannot or should not advance (such as religion), private philanthropic organizations can be uniquely qualified to initiate thought and action, experiment with new and untried ventures, dissent from prevailing attitudes, and act quickly and flexibly.

Private foundations have an important part in this work. Available even to those of relatively restricted means, they enable individuals or small groups to establish new charitable endeavors and to express their own bents, concerns, and experience. In doing so, they enrich the pluralism of our social order. Equally important, because their funds are frequently free of commitment to specific operating programs, they can shift the focus of their interest and their financial support from one charitable area to another. They can, hence, constitute a powerful instrument for evolution, growth, and improvement in the shape and direction of charity.

B. EVALUATION OF GENERAL CRITICISMS OF PRIVATE FOUNDATIONS

Three broad criticisms have been directed at private foundations. It has been contended that the interposition of the foundation between the donor and active charitable pursuits entails undue delay in the transmission of the benefits which society should derive from charitable contributions; that foundations are becoming a disproportionately large segment of our national economy; and that foundations represent dangerous concentrations of economic and social power. Upon the basis of these contentions, some persons have argued that a time limit should be imposed on the lives of all foundations. Analysis of these criticisms, however, demonstrates that the first appears to be susceptible of solution by a measure of specific design and limited scope, the second lacks factual basis, and the third is, for the present, being amply met by foundations themselves. As a consequence, the Treasury Department has concluded that prompt and effective action to end the specific abuses extant among foundations is preferable to a general limitation upon foundation lives.

II. Major Problems

The Treasury Department's study of private foundations has revealed the existence of six categories of major problems.

A. SELF-DEALING

Some donors who create or make substantial contributions to a private foundation have engaged in other transactions with the foundation. Property may be rented to or from it; assets may be sold to it or purchased from it; money may be borrowed from it or loaned to it. These transactions are rarely necessary to the discharge of the foundation's charitable objectives; and they give rise to very real danger of diversion of foundation assets to private advantage.

Cognizant of this danger, the House of Representatives in 1950 approved a bill which would have imposed absolute prohibitions upon most financial intercourse between foundations and donors or related parties, and which would have severely restricted other such dealings. However, the measure finally adopted, which has been carried without material change into present law, prohibits only loans which do not bear a "reasonable" rate of interest and do not have "adequate" security, "substantial" purchases of property for more than "adequate" consideration, "substantial" sales of property for less than "adequate" consideration, and certain other transactions.

Fourteen years of experience have demonstrated that the imprecision of this statute makes the law difficult and expensive to administer, hard to enforce in litigation, and otherwise insufficient to prevent abuses. Whatever minor advantages charity may occasionally derive from the opportunity for free dealings between foundations and donors are too slight to overcome the weight of these considerations. Consequently, the Report recommends legislative rules patterned on the total prohibitions of the 1950 House bill. The effect of this recommendation would, generally, be to prevent private foundations from dealing with any substantial contributor, any officer, director, or trustee of the foundation, or any party related to them, except to pay reasonable compensation for necessary services and to make incidental purchases of supplies.

B. DELAY IN BENEFIT TO CHARITY

The tax laws grant current deductions for charitable contributions upon the assumption that the funds will benefit the public welfare. This aim can be thwarted when the benefits are too long delayed. Typically, contributions to a foundation are retained as capital, rather than distributed. While this procedure is justified by the advantages which private foundations can bring to our society, in few situations is there justification for the retention of income (except long-term capital gains) by foundations over extended periods. Similarly, the purposes of charity are not well served when a foundation's charitable disbursements are restricted by the investment of its funds in assets which produce little or no current income.

Taking note of the disadvantages to charity of permitting unrestricted accumulations of income, Congress in 1950 enacted the predecessor of section 504 of the present Internal Revenue Code, which denies an organization's exemption for any year in which its income accumulations are (a) "unreasonable" in amount or duration for accomplishing its exempt purposes, (b) used to a "substantial" degree for other purposes, or (c) invested in a way which "jeopardizes" the achievement of its charitable objectives.[1] The indefiniteness of the section's standards, however, has rendered this provision difficult to apply and even more difficult to enforce. Two changes in the law are needed for private foundations which do not carry on substantial active charitable endeavors of their own.

First, such private foundations should be required to devote all of their net income[2] to active charitable operations (whether conducted by themselves or by other charitable organizations) on a reasonably current basis. To afford flexibility, the requirement should be tempered by a 5-year carryforward provision and a rule permitting accumulation for a specified reasonable period if their purpose is clearly designated in advance and accumulation by the foundation is necessary to that purpose.

Second, in the case of nonoperating private foundations which minimize their regular income by concentrating their investments in low yielding assets, an "income equivalent" formula should be provided to place them on a parity with foundations having more diversified portfolios. This result can be accomplished by requiring that they disburse an amount equal either to actual foundation net income[2] or to a fixed percentage of foundation asset value, whichever is greater.

C. FOUNDATION INVOLVEMENT IN BUSINESS

Many private foundations have become deeply involved in the active conduct of business enterprises. Ordinarily, the involvement takes the form of ownership of a controlling interest in one or more corporations which operate businesses; occasionally, a foundation owns and operates a business directly. Interests which do not constitute control may nonetheless be of sufficient magnitude to produce involvement in the affairs of the business.

Serious difficulties result from foundation commitment to business endeavors. Regular business enterprises may suffer serious competitive disadvantage. Moreover, opportunities and temptations for subtle and varied forms of self-dealing—difficult to detect and impossible completely to proscribe—proliferate. Foundation management may be drawn from concern with charitable activities to time-consuming concentration on the affairs and problems of the commercial enterprise.

For these reasons, the Report proposes the imposition of an absolute limit upon the participation of private foundations in active business, whether presently owned or subsequently acquired. This recommendation would prohibit a foundation from owning, either directly or through stock holdings, 20 percent or more of a business unrelated to the charitable activities of the foundation (within the meaning of sec. 513). Foundations would be granted a prescribed reasonable period, subject to extension, in which to reduce their present or subsequently acquired business interests below the specified maximum limit.

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[1] Section 681 imposes similar restrictions upon nonexempt trusts which, under section 642(c), claim charitable deductions in excess of the ordinary percentage limitations on individuals' deductible contributions.
[2] Except long-term capital gains.

D. FAMILY USE OF FOUNDATIONS TO CONTROL CORPORATE AND OTHER PROPERTY

Donors have frequently transferred to private foundations stock of corporations over which the donor maintains control. The resulting relationships among the foundation, corporation, and donor have serious undesirable consequences which require correction. Similar problems arise when a donor contributes an interest in an unincorporated business, or an undivided interest in property, in which he or related parties continue to have substantial rights. In all of these situations, there is substantial likelihood that private interests will be preferred at the expense of charity. Indeed, each of the three major abuses discussed thus far may be presented in acute form here. The problems here are sufficiently intensified, complex, and possessed of novel ramifications to require a special remedy.

To provide such a remedy, the Treasury Department recommends the adoption of legislation which, for gifts made in the future, would recognize that the transfer of an interest in a family corporation or other controlled property lacks the finality which should characterize a deductible charitable contribution. Under this recommendation, where the donor and related parties maintain control of a business or other property after the contribution of an interest in it to a private foundation, no income tax deduction would be permitted for the gift until (*a*) the foundation disposes of the contributed asset, (*b*) the foundation devotes the property to active charitable operations, or (*c*) donor control over the business or property terminates. Correlatively, the recommended legislation would treat transfers of such interests, made at or before death, as incomplete for all estate tax purposes unless one of the three qualifying events occurs within a specified period (subject to limited extension) after the donor's death. For the purposes of this rule, control would be presumed to exist if the donor and related parties own 20 percent of the voting power of a corporation or a 20 percent interest in an unincorporated business or other property. This presumption could be rebutted by a showing that a particular interest does not constitute control. In determining whether or not the donor and related parties possess control, interests held by the foundation would be attributed to them until all of their own rights in the business or other underlying property cease.

The Treasury Department has given careful consideration to a modification of this proposal which would postpone the donor's deduction only where, after the contribution, he and related parties control the business or other underlying property and, in addition, exercise substantial influence upon the foundation to which the contribution was made. Such a rule would permit an immediate deduction to a donor who transfers controlled property to a foundation over which he does not have substantial influence. Analysis of this modification indicates that it possesses both advantages and disadvantages. Congressional evaluation of the matter, hence, will require careful balancing of the two.

E. FINANCIAL TRANSACTIONS UNRELATED TO CHARITABLE FUNCTIONS

Private foundations necessarily engage in many financial transactions connected with the investment of their funds. Experience has, however, indicated that unrestricted foundation participation in three classes of financial activities which are not essential to charitable operations or investment programs can produce seriously unfortunate results.

Some foundations have borrowed heavily to acquire productive assets. In doing so, they have often permitted diversions of a portion of the benefit of their tax exemptions to private parties, and they have been able to swell their holdings markedly without dependence upon contributors. Certain foundations have made loans whose fundamental motivation was the creation of unwarranted private advantage. The borrowers, however, were beyond the scope of reasonable and administrable prohibitions on foundation self-dealing, and the benefits accruing to the foundation's managers or donors were sufficiently nebulous and removed from the loan transactions themselves to be difficult to discover, identify, and prove. Some foundations have participated in active trading of securities or speculative practices.

The Treasury Department recommends special rules to deal with each of these three classes of unrelated financial transactions. First, it proposes that all borrowing by private foundations for investment purposes be prohibited.[3] Second, it recommends that foundation loans be confined to categories which are clearly necessary, safe, and appropriate for charitable fiduciaries. Third, it proposes that foundations be prohibited from trading activities and speculative practices.

F. BROADENING OF FOUNDATION MANAGEMENT

Present law imposes no limit upon the period of time during which a donor or his family may exercise substantial influence upon the affairs of a private foundation. While close donor involvement with a foundation during its early years can provide unique direction for the foundation's activities and infuse spirit and enthusiasm into its charitable endeavors, these effects tend to diminish with the passage of time, and are likely to disappear altogether with the donor's death. On the other hand, influence by a donor or his family presents opportunities for private advantage and public detriment which are too subtle and refined for specific prohibitions to prevent; it provides no assurance that the foundation will receive objective evaluation by private parties who can terminate the organization if, after a reasonable period of time, it has not proved itself; and it permits the development of narrowness of view and inflexibility in foundation management. Consequently, the Treasury Department recommends an approach which would broaden the base of foundation management after the first 25 years of the foundation's life. Under this proposal, the donor and related parties would not be permitted to constitute more than 25 percent of the foundation's governing body after the expiration of the prescribed period of time. Foundations which have now been in existence for 25 years would be permitted to continue subject to substantial donor influence for a period of from 5 to 10 years from the present time.

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[3] This recommendation would not prevent foundations from borrowing money to carry on their exempt functions.

III. ADDITIONAL PROBLEMS

Review of the practices of private foundations and their contributors discloses the existence of several problems which have less general significance than those discussed in Part II of the report. Part III of the report draws the following conclusions about these problems:

A. Gifts to private foundations of certain classes of unproductive property should not be deductible until the foundation sells the property, makes it productive, applies it to a charitable activity, or transmits it to a charitable organization other than a private foundation.

B. Charitable deductions for the contribution to private foundations of section 306 stock (generally, preferred stock of a corporation whose common stock is owned by the donor) and other assets should be reduced by the amount of the ordinary income which the donor would have realized if he had sold them.

C. Reforms of a technical nature should be made in certain estate tax provisions which govern tax incidents of contributions to private foundations.

D. A sanction less severe than the criminal penalty of existing law should apply for the failure to file a return required of a private foundation.

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These Treasury Department proposals are based upon a recognition that private foundations can and do make a major contribution to our society. The proposals have been carefully devised to eliminate subordination of charitable interests to personal interests, to stimulate the flow of foundation funds to active, useful programs, and to focus the energies of foundation fiduciaries upon their philanthropic functions. The recommendations seek not only to end diversions, distractions, and abuses, but to stimulate and foster the active pursuit of charitable ends which the tax laws seek to encourage. Any restraints which the proposals may impose on the flow of funds to private foundations will be far outweighed by the benefits which will accrue to charity from the removal of abuses and from the elimination of the shadow which the existence of abuse now casts upon the private foundation area.

PART I. APPRAISAL OF PRIVATE FOUNDATIONS

The Internal Revenue Code provides very significant preferential treatment for philanthropic organizations. Not only does it exempt such organizations from income tax (a status they share with many other nonprofit organizations), but it grants income, gift, and estate tax deductions to persons contributing funds to them. The allowance of these deductions results in a very sizable reduction in tax revenues. In 1963, for example, the charitable deductions claimed by individuals, corporations, and estates diminished Federal revenues by a total of approximately $2,800 million.[1]

While private foundations have, in general, received the same favorable treatment accorded all philanthropic organizations, several noteworthy qualifications have been made for them. In 1950 rules concerning prohibited transactions (now secs. 503 and 681(b)) and unreasonable accumulation of income (now secs. 504 and 681(c)) were applied to foundations. In 1964, when Congress increased the general limitation upon the amount of deductible charitable contributions which individuals can make each year from 20 percent of adjusted gross income to 30 percent, it excluded donations to private foundations from the increase (continuing the 20 percent ceiling on them). At the same time, Congress placed special limitations upon the kinds of foundations which can qualify to receive the unlimited charitable contributions permitted to individuals in certain instances. The limitations were designed, generally, to confine this privilege to foundations which do not engage in financial transactions with their donors or related parties, and which actively engage in charitable operations or which pass funds on to active charities without undue delay. A third differentiation between private foundations and other classes of philanthropic organizations occurred in 1964 legislation: in initiating a provision allowing individuals a 5-year carryover of charitable contributions which, in a particular year, exceed deductible limits, Congress did not extend this benefit to contributions made to foundations.

The 1964 decisions by Congress restricting the favorable tax treatment accorded private foundations represent a carefully considered balancing of the relative needs and values of foundations against those of other kinds of charitable organizations. The Treasury Department concurs in the judgment of Congress on these matters; it should be allowed to stand. The vital present question is whether or not additional restrictions are necessary.

To provide an informed response to this question, one must inquire into several fundamental problems. What are the values of private philanthropy? Do private foundations contribute to them? If so, what is the character of that contribution? Is it likely to be attended by undesirable consequences? Are specific measures available to forestall such consequences, or can they be dealt with only by provisions of general scope?

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[1] This total does not, of course, represent a net loss to the Government. As is pointed out in greater detail below, private charitable expenditures reduce the need for Government spending.

A. PHILANTHROPIC VALUES AND PRIVATE FOUNDATIONS

The income tax deduction for individuals' gifts to charity was added to the law in 1917, at a time when income tax rates were being raised to meet the expense of war. The addition was justified on the ground that heavy income taxes might cause reductions in donations to charity. Similar considerations subsequently led to the enactment of gift and estate tax deductions for charitable transfers and the extension of the income tax deduction to corporations.

It is impossible accurately to assess the gain or loss in Government funds resulting from the charitable deduction. We cannot know by what amount charitable contributions would be reduced if there were no tax deductions for them. Similarly, we cannot know what increase in Government spending would be required to compensate for reduced charitable spending.

A more important imponderable exists—the distinctive value of private philanthropy. Such philanthropy plays a special and vital role in our society; Government services cannot provide a satisfactory substitute. Religious activity is perhaps unique, because Government is constitutionally barred from undertaking it. Here, private freedom of choice is the preeminent consideration. But in other fields, too, Government is best restricted to a partial and, perhaps, minor role. Research in some of the more controversial areas of the social sciences is an example. Even with respect to activities in which Government must take a major part today—such as education, social security, relief and elimination of poverty—charitable organizations may make vital and unique contributions.

Private philanthropic organizations can possess important characteristics which modern government necessarily lacks. They may be many-centered, free of administrative superstructure, subject to the readily exercised control of individuals with widely diversified views and interests. Such characteristics give these organizations great opportunity to initiate thought and action, to experiment with new and untried ventures, to dissent from prevailing attitudes, and to act quickly and flexibly. Precisely because they can be initiated and controlled by a single person or a small group, they may evoke great intensity of interest and dedication of energy. These values, in themselves, justify the tax exemptions and deductions which the law provides for philanthropic activity.

Private foundations play a significant part in the work of philanthropy. While the foundation is a relatively modern development, its predecessor, the trust, has ancient vintage. Like its antecedent, the foundation permits a donor to commit to special uses the funds which he gives to charity. Rather than being compelled to choose among the existing operating organizations, he can create a new fund, with its own areas of interest and emphasis. His foundation may encourage existing operating organizations to develop in new directions, or it may lead to the formation of new organizations. Even if it does neither, it reflects the bents, the concerns, and the experience of its creator; and it thereby increases the diversity of charitable works. In these ways, foundations have enriched and strengthened the pluralism of our social order.

Private foundations have also preserved fluidity and provided impetus for change within the structure of American philanthropy. Operating charitable organizations tend to establish and work within defined patterns. The areas of their concern become fixed, their goals set, their major efforts directed to the improvement of efficiency and effectiveness within an accepted framework. Their funds are typically consigned to definite—and growing—budgets. The assets of private foundations, on the other hand, are frequently free of commitment to specific operating programs or projects; and that freedom permits foundations relative ease in the shift of their focus of interest and their financial support from one charitable area to another. New ventures can be assisted, new areas explored, new concepts developed, new causes advanced. Because of its unique flexibility, then, the private foundation can constitute a powerful instrument for evolution, growth, and improvement in the shape and direction of charity.

B. EVALUATION OF GENERAL CRITICISMS OF FOUNDATIONS

Several serious general criticisms have been leveled at the private foundation. Some argue that the interposition of the foundation between the donor and active charitable pursuits entails undue delay in the transmission of the benefits which society should derive from charitable contributions. Others contend that foundations are coming to constitute a disproportionately large share of our national economy and hence, among other things, are biting deeply into our tax base. Still others urge that foundations represent dangerous concentrations of uncontrolled economic and social power. Such contentions have led to proposals that a time limit be imposed on the life of private foundations.

The Treasury Department does not believe that a case for this proposal has been made. Its investigation has indicated that most private foundations act responsibly and contribute significantly to the improvement of our society. Because of the very nature of their activities and aims, precise judgment is impossible upon the extent to which foundations have realized their potentialities for creative and dynamic charitable works. It seems quite clear, however, that their endeavors have been conducive to important advancements in education, health, science, the arts, religion, and assistance to the needy and unfortunate.

The argument that foundations can occasion unwarranted delay in benefits to charity possesses considerable force; for, in particular situations, there have been aggravated instances of such delay. But the appropriate solution would appear to be a measure specifically designed to deal directly with this problem—not a rule, like the proposal for limiting foundation life, whose impact would extend well beyond the boundaries of the problem itself. Part II–B of the report outlines a recommendation framed to meet the specific exigencies of the delay problem; and the Treasury Department believes that the measure will prove adequate to its task.

The contention that foundation holdings have become an excessively large part of the national economy in recent years finds little support in the relevant data. Appendix A explores this matter in some detail. While the available information is far from definitive, it suggests that, since 1950, foundation wealth has not grown appreciably faster than other segments of the economy which have substantial investments in common stocks. The existing restrictions on charitable deductions for contributions to foundations would seem to provide a significant restraint upon abnormal growth. Hence, there would appear to be little present factual basis for the assertion that foundation lives should be limited because foundation wealth has become disproportionate.

To be sure, the powers of foundations present potential dangers. Many foundations have recognized that fact themselves. The larger foundations have acknowledged and responded to their obligations to the public. They have, in the main, established boards of independent, disinterested trustees, and have attracted skilled professional staffs. They have developed procedures which safeguard the independence of their grantees. Quite generally, they have accepted—and often encouraged—public scrutiny of their operations. Undoubtedly there have been individual instances of questionable expenditure; but, upon the whole, the record of foundation disbursements is one of solid accomplishment.

Serious abuses do exist among a minority of private foundations, and they require correction and restraint. They interfere with the application of the funds of some foundations to their proper charitable purposes. Since the Federal tax laws have played a significant part in the growth of foundations, an unavoidable responsibility rests upon the Federal Government to do what it reasonably can to insure that these organizations operate in a manner conducive to the fulfillment of their purposes. The Treasury Department does not, however, recommend that any separate Federal regulatory agency be created to supervise foundations. Rather, the Department is of the view that the effort should be made to frame the tax laws themselves to curb abuses.

Succeeding Parts of this report analyze the character of the abuses which have arisen and recommend remedies for them. The Treasury Department believes that vigorous and fully effective action can and should be taken to end these abuses. It considers such action to be preferable to measures of broader scope and more fundamental impact, such as some limitation upon the lives of all private foundations.

PART II. MAJOR PROBLEMS

A. SELF-DEALING

(1) *The existing situation*

Existing law does not prohibit donor-foundation transactions. As a result, it is presently possible for a donor to enter into a number of transactions with a foundation to which he has made substantial contributions. For example, he may borrow the foundation's funds or have the foundation lend its funds to a business which he controls. He may have the foundation use its liquid assets to purchase either his property or property owned by others which he wishes to keep from being acquired by competitors or other unfriendly parties. He may have his foundation rent its property to him. He may purchase the foundation's assets.

The lack of a prohibition upon donor-foundation transactions has led some donors to believe that although the foundation has legal title to assets which they have contributed, such assets still "belong" to them. Such a donor often thinks of a foundation as "his" foundation and feels free to engage in any transaction with it that does not shock the conscience—and even some that do. This same belief may be shared by some foundation officials who do not object when the donor wishes to engage in financial transactions with "his" own foundation. These officials apparently feel that the foundation's funds belong to the donor and should be handled in the manner which the donor wishes, rather than in the manner which would benefit the public.

(2) *Consequences of existing situation*

The ability of a donor to deal with his foundation has several undesirable consequences. First, the donor's knowledge that he may call upon his foundation's assets for his personal purposes will often affect the exercise of his discretion as an official of the foundation in determining how much of the foundation's income and corpus should be distributed to charity on a current basis. The extent to which the failure of some private foundations to distribute their entire income to public charities is traceable to the desires of their trustees to have funds available for the needs of the donor is unascertainable. However, it is likely that it is not an unimportant consideration in some cases.

Second, transactions between a donor and his foundation often provide subtle private advantages to the donor. For example, even if a donor who borrows the foundation's funds is willing to pay the same rate of interest and to provide the same security as would be required by a bank, he usually can be sure that the foundation would not request a detailed financial statement or ask the personal and often embarrassing questions, such as the use to which the funds will be put, that are usually asked when one borrows from a bank. In addition, it is likely that the foundation will always be willing to lend its funds to the donor and process the donor's "loan application" without any of the delay which might take place if the donor were to borrow from a bank. Thus existing law can provide a donor with a certain source of capital upon which he can call in time of need. Furthermore, the foundation might be more willing to withhold collection of the loan at its maturity—especially if it would embarrass the donor—than would be the case if the loan were made by a bank whose obligation to protect its depositors and shareholders would not permit an extension merely to accommodate the borrower. While all of these advantages are intangible, they do provide the donor who takes advantage of the opportunity with a substantial and valuable benefit.

Third, the knowledge that his foundation can be used as a source of capital—even at the prevailing interest rates—can influence the decisions of the donor in his capacity as an official of the foundation as to the assets which the foundation should hold in its portfolio. A donor who thinks that he may want to call upon his foundation for funds at some future date may have the foundation keep its funds in a form readily convertible into cash so as to be immediately available for his use, rather than placed in an investment which would be more appropriate for the production of income, but which would not be readily convertible into the liquid funds which the donor may need. Such action would, in many cases, decrease the amount of income which the foundation would be able to expend for charitable purposes.

Fourth, the ability of a donor to engage in financial transactions with his foundation results in discrimination between taxpayers. For example, if taxpayer A wants to make his funds available to his business he must do so out of after-tax dollars. However, if taxpayer B, who has established a private foundation, wishes to do the same thing he may "donate" cash (or appreciated property) to his foundation and have the foundation immediately lend the "contribution" to B's business. Assuming that B is in the 50-percent bracket, he can place twice as much cash at the disposal of his business as A, even though both have decreased their disposable funds by the same amount. It is true that the amount borrowed by the B company will have to be paid to the B foundation and not to B. However, the present value to B of being able to put twice as much capital into his business than would otherwise be possible may often exceed the value of the right to collect the debt at some time in the future. Similarly, taxpayer C cannot claim as a deduction an amount which he has pledged to his favorite charity, even though the pledge may be enforceable by the charity. On the other hand, taxpayer D, who has established a private foundation, can "contribute" the same amount to his foundation and then borrow the "contribution" from the foundation. Under these facts D could deduct the contribution but C could not, even though in both cases charity has received the same thing—an obligation of the donor.

Finally, the ability of donors to engage in financial transactions with their foundations is adversely affecting taxpayer morale. Many feel that allowing contributions to a foundation to be deductible in situations in which the donor has not irrevocably parted with the "donated" property is improper. The belief is becoming more widespread that the creation of a private foundation is a tax dodge used by some taxpayers to obtain tax advantages, much as expense account living was regarded. Under our self-assessment tax system it is important that the public have confidence in the fact that every taxpayer is paying his fair share of the cost of government.

(3) *Prior attempt to solve problem—1950 legislation*

The abuses which may exist where a donor is able to enter into financial transactions with his private foundation were recognized by the House of Representatives in 1950. In that year the Ways and Means Committee approved, and the House adopted, a provision which, generally, would have prohibited foundations from entering into financial transactions with (1) its contributors, (2) its officers, directors, and trustees, and (3) certain parties related to its contributors, officers, directors, and trustees.

The Senate Finance Committee, after considering this problem, agreed that there were abuses under the law as it had existed prior to the Revenue Act of 1950. However, the committee believed that the abuses could be prevented without prohibiting transactions which are at arm's length. Therefore, the Finance Committee approved, and the Senate adopted, a provision which would only prohibit a foundation from—

(1) lending any part of its income or corpus without receipt of *adequate security* and a *reasonable rate of interest;*

(2) paying any compensation *in excess of a reasonable allowance* for salaries or other compensation for personal services actually rendered;

(3) making any part of its services available on a *preferential basis;*

(4) making any *substantial purchase* of securities or any other property for *more than adequate consideration* in money or money's worth;

(5) *selling any substantial part* of its securities or other property for *less than adequate consideration* in money or money's worth; and

(6) engaging in any other transaction which results in a *substantial diversion* of its income or corpus.

These prohibitions applied only to transactions between a foundation and its donor (and certain related parties); they were not made applicable to transactions between a foundation and its officers, directors, or trustees.

In conference, the Senate version was adopted. The rules adopted in 1950 can presently be found in sections 503 and 681 of the Internal Revenue Code.

It is now almost 15 years since the enactment of the Revenue Act of 1950. At this time, it is appropriate—indeed necessary—to reexamine the action taken in 1950.

(4) *Evaluation of existing law*

A careful study of the self-dealing transactions which take place under existing law indicates that the 1950 legislation—which only prohibits donor-foundation transactions which violate an arm's length standard—provides unsatisfactory results.

When a person is asked to represent two conflicting interests in the same transaction it is likely that he will, consciously or unconsciously, favor one side over the other. Where one of the interests involved is his own, and if his action will not be questioned by a charitable beneficiary, it is likely that the donor will resolve all close questions in his own favor. For example, it is likely that a donor would be willing to give himself the benefit of the doubt as to "reasonableness" of the interest and "adequacy" of the security provided for in donor-foundation loans. Anglo-American trust law has long recognized the impossibility of insuring that a trustee who is permitted to deal with himself will act fairly to the trust. As a result, the courts have refused to inquire as to the fairness of dealings between a trustee and a trust and have generally barred such transactions.

Because of the potential private benefit which may result from self-dealing, it is imperative that the Internal Revenue Service examine such transactions in detail in order to determine whether there has been a violation of the existing rules. However, such examinations require the skill of highly trained revenue agents and are both time consuming and expensive. The Internal Revenue Service has estimated that the "cost" (both direct costs and the amount of revenue which would be produced if the agent were free to spend his time on matters involving the collection of taxes) of 1 man-year of an experienced revenue agent's time exceeds $320,000.

Much of the Service's problem in policing self-dealing transactions is traceable to concepts such as "reasonableness" and "adequacy" and measures such as "substantial" which are contained in the existing self-dealing rules. The administrative problems created by the use of such terms are severe in the foundation area. This is largely attributable to the fact that often no one is looking over the shoulder of the trustee of a private foundation to make sure that the transaction is, in fact, at arm's length. Indeed, the "arms" involved may both belong to the same person who is both donor and trustee. Moreover, the possibility of arranging transactions with a foundation to suit the needs of the donor are more numerous than in other areas. For example, if a donor wishes to obtain the use of the foundation's funds at a minimum cost he will arrange for the loan to bear a low rate of interest. On the other hand, if a donor wishes to make a deductible contribution to his foundation which is in excess of the generally applicable percentage limitation, it would be possible for him to set a high rate of interest.

The following examples indicate the types of self-dealing cases which are being entered into and the difficulty which the Internal Revenue Service has in applying the arm's length test contained in existing law:

> *Example 1.*—The A foundation made a loan to a business corporation controlled by its donor. The security for the loan consisted of an oral promise made by the donor as an officer of the corporation to execute a mortgage on certain of the real property owned by the corporation, but only if the foundation requested such a mortgage. The foundation, however, never requested the donor's corporation to execute such a mortgage. The Internal Revenue Service challenged the exemption of the foundation on the grounds that the organization had made a loan without the receipt of "adequate" security. The Service argued that if the corporation were to become insolvent, the foundation, with only an unrecorded promise to execute a mortgage in the future, would be in the same position as any other unsecured creditor. However, the court, although recognizing that the security interest of the foundation would be ineffective if the corporation disposed of the real property, felt that a mere promise to execute a mortgage in the future constituted "adequate" security. Thus,

the foundation's exemption was upheld. *William Clay, Jr. Foundation* v. *United States* (64-2 USTC ¶ 9650 (N.D. Tex. 1964) (CCH).

Example 2.—The B foundation was able to make 12 loans totaling over $200,000 to the donor, his relatives, and corporations controlled by the donor without losing its exempt status. *Griswold* v. *Commissioner* 39 T.C. 620 (1962).

Example 3.—The donor contributed $65,000 to the C foundation. These funds were immediately lent to a corporation owned by the donor. Thus, the donor was able to claim an immediate deduction for funds which were invested in his business.

Example 4.—The D foundation lent a substantial portion of its cash to its donor on negotiable demand notes bearing interest at 5½ percent. The collateral for this loan was common stock in one of the donor's closely held corporations. The examining agent stated that the donor was using the foundation "as a bank or checking account."

Example 5.—The E foundation, during the 5-year period 1955–59, made 29 loans to its donor. These loans, totaling approximately $145,000, bore interest at the rate of 4 percent and were secured by stock in a closely held corporation. Although each of these loans were repaid by the end of the foundation's accounting period, some of the funds were "relent" to the donor in the opening days of the following year. Since there were no open loans as of the last day of the foundation's accounting period, the presence of such loans was not disclosed by its balance sheet.

Example 6.—The donor to the F foundation organized a separate corporation for the purpose of manufacturing an article on which he owned the patent. He borrowed money from a bank, lent it to the corporation, and received secured promissory notes as evidence of the debt. Shortly thereafter, the donor contributed (and deducted) certain of these notes—amounting to $27,500—to the foundation. The corporation subsequently abandoned the attempt to manufacture the patented article and the notes became worthless. This transaction permitted the taxpayer to obtain a large contribution deduction for what was essentially "risk capital" for his new business. If the corporation had proved to be successful, the donor, as its stockholder, would have benefited from the additional capital which was made available. However, since the corporation did not prove to be successful, it was only the charity that suffered—the donor had already obtained a deduction for his gift of the corporation's notes.

Example 7.—A donor contributed real estate to the G foundation. Shortly thereafter the foundation leased these properties back to the donor for rentals of approximately $10,000 and $12,000 for 1960 and 1961, respectively. The donor then sublet these properties to third parties for approximately $12,000 and $20,000 for 1960 and 1961, respectively. The donor alleged that the gain which he received was attributable to management services which he performed.

Example 8.—The H foundation received approximately $400,000 in deductible contributions from the owners of a retail and wholesale grocery concern. The foundation distributed a small portion of these contributions to operating charitable organizations. The remainder of the contributions were used to construct buildings which were leased to the donors' retail grocery.

Example 9.—In 1950 the corporate donor to the I foundation purchased land adjacent to its property for future plant expansion. In 1951 the company donated to the foundation the portion of this land which it did not need in the near future. This gave the company a deduction of approximately $10,000. Some 11 years later, consistent with the company's expansion plans, the property was sold back to the company for an amount equal to approximately $900 more than the amount claimed as a contribution.

Example 10.—The J foundation purchased 20,000 shares of common stock in a publicly held corporation from its donor at $20 per share. On the date of the sale, the stock traded on the New York Stock Exchange at $18 per share. However, because of the number of shares involved and the fact that four brokerage houses stated that $20 per share was not more than adequate consideration, a violation of the arm's-length standard could not be proved.

Example 11.—The K foundation received gifts of "blue chip" stocks valued at $1.2 million from its principal donor. Immediately after receipt the securities were sold by the foundation and all but approximately $50,000 of the proceeds were used to purchase stock in a closely held corporation from members of the donor's family.

Example 12.—The L foundation received stock in a family corporation which was subject to a 10-year option exercisable by the donor's children to repurchase the stock. At the time of the gift the stock was worth approximately $500,000 and the option price was approximately $700,000. Six years later the value of stock had risen to approximately $5,500,000 and the donor's children exercised their right to purchase the stock for $700,000. The use of a repurchase option permitted the donor to divert any substantial appreciation in the value of the donated asset to private parties. Since the foundation could not have received more than $700,000 for the stock, the retention of the stock—in order to accommodate the donor's children—tied up its funds and prevented it from investing in assets which might provide more income for charity. The foundation, at the same time, bore the risk of loss on the stock.

Under existing law, some of these transactions may jeopardize the deductibility of the donor's contribution or the foundation's exemption. Others have received the approval of the courts. However even with respect to those which are not permitted under existing law, the problems of obtaining all of the facts surrounding these transactions often make it extremely difficult, if not impossible, for the Internal Revenue Service to administer the existing law in a manner which prevents foundations from engaging in self-dealing transactions providing a special benefit to the donor at the expense of charity.

Presumably the only justification for continuing to pay the high cost of a rigorous enforcement program which the existing self-dealing rules require would be that charity benefits from allowing a donor to deal with "his" foundation and that this benefit is so substantial and important that it warrants the high cost of administering existing law. However, after a careful review of this subject, it is clear that while there may be a few isolated cases in which charity does benefit by allowing a foundation to enter into financial transactions with its contributors, the benefit which may accrue to charity from such transactions is far outweighed by the inherent potential for private benefit (with a corresponding loss to charity), by the cost of enforcing an arm's-length standard, and by the damage to the confidence of all taxpayers in the fairness of the tax laws.

(*5*) *Possible solution*

Since examination of this area has revealed that the public does not receive an over-all benefit from allowing a donor to deal with his private foundation, it is recommended that a general prohibition on self-dealing be adopted, applicable to future transactions. This rule would not only eliminate the undue burden of administering an arm's-length test but would also eliminate the potential for abuse which exists under present law. It would also be desirable from the standpoint of over-all tax policy since it would eliminate the ability of a person who presently enters into financial transactions with his private foundation to obtain an immediate charitable deduction without fully parting with his property.

Moreover, such a rule would eliminate the undesirable influences which the ability to engage in self-dealing may have upon a foundation's charitable activities. Such a prohibition would be consistent with the long-established nontax law which bans all self-dealing between a trustee and the trust with respect to which it is a fiduciary. Such a rule would also be consistent with the trend of tax provisions enacted by the Congress since 1950 relating to exempt organizations.[1]

More specifically, it is recommended that private foundations be prohibited from engaging in any transaction with a donor or parties related to the donor involving the transfer or use of the foundation's assets.[2] Illustrative of the self-dealing transactions which a private foundation would be prohibited from entering into under this general rule (though the rule would not be limited to these transactions) would be—

(1) lending any part of its income or corpus to;
(2) paying compensation (other than reasonable compensation for personal services actually rendered) to;
(3) making any of its services available on a preferential basis to;

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[1] In 1962 the Congress, concerned with the possibility of self-dealing in the case of pension trusts established by self-employed taxpayers, placed a general prohibition on self-dealing between the self-employed person and his pension trust. Briefly, this provision prevented such a trust from—

(1) lending any part of its income or corpus to;
(2) paying any compensation for personal services to;
(3) selling any of its property to; and
(4) acquiring any property for the trust from—

a self-employed person covered by the trust or certain parties connected with such persons (sec. 503(j)).

The Revenue Act of 1964 also imposed a general prohibition on self-dealing transactions in the case of private foundations eligible to receive "unlimited contributions." Under these rules such a private foundation may not—

(1) lend any part of its income or corpus to;
(2) purchase more than a minimal amount of property from; or
(3) sell more than a minimal amount of property to—

the donor and certain parties connected with the donor (sec. 170(g)(4)).

[2] The definition of a private foundation should include a trust which makes distributions to charitable and noncharitable parties. The absolute prohibition on donor-foundation transactions would not, of course, prevent such a trust from making distributions to the donor or members of his family which are required under the terms of the trust instrument.

(4) purchasing or leasing its property from; and
(5) selling or leasing its property to—

the donor and certain parties who are so closely connected with the foundation as to lead to potential abuse. Indirect transactions, such as a loan by the donor to a corporation which he controls—followed by a gift of the corporation's note to the foundation, would also be prohibited.

A permissible exception to this rule would allow a foundation to purchase incidental supplies from the donor or business organizations with which he may be connected. This would, for example, allow a foundation to purchase its office supplies from a stationery concern owned by a contributor.

A second exception which may be appropriate would permit the donor and certain donor-related parties to purchase at fair market value those assets which the foundation would be required to dispose of under the recommendations set forth in subsequent portions of this report.

The only other exception which should be made would allow a donor to make an interest-free loan to a foundation if such a loan were to be used for bona fide charitable purposes. Such a transaction would not appear to raise a danger of abuse.

The desirability of permitting a foundation to purchase property from a donor where the market value of the property can clearly be established and the purchase price is substantially less than such market value has been considered. Such an exception, however, would be unwise. First, it would encourage a donor to sell appreciated property to a foundation for an amount equal to his cost and claim as a charitable contribution the difference between his cost and market value. Such transactions, commonly referred to as "bargain sales," allow a donor to contribute only the portion of the value of the property which represents unrealized (and untaxed) appreciation and to obtain cash equal to his cost without the imposition of any tax on the untaxed appreciation. Such transactions give unusual benefits to the donor and, at least in the area of private foundations, should not be encouraged. Second, and perhaps more important, it is not always possible to distinguish between property whose value can be readily ascertained and property whose value it is difficult to ascertain. Such a rule, therefore, would be difficult to administer. Furthermore, a distinction between stocks which are traded on a stock exchange or in an over-the-counter market and stocks which are not, as such a rule would probably entail, would introduce a discriminatory feature into the law of private foundations. For these reasons the exception would not be desirable.

To make these suggested rules fully effective, the existing definition of parties who are considered to be related to the donor should be expanded somewhat to include corporations in which the donor and the members of his family own 20 percent or more of the stock. Directors, officers, and persons who hold 20 percent or more of the stock of a corporation which is a substantial contributor to a foundation should also be considered donor-related parties. This would, in effect, prevent a company foundation from lending its funds to an officer of its major contributor. In addition, a donor to a private foundation should not be permitted to enter into financial transactions with a business corporation which the foundation controls. Thus, if a foundation owns a building, the donor should not be able to avoid the self-dealing rules by having the foundation place the building in a separate corporation which would then rent the building to the donor. Furthermore, this prohibition of financial transactions should be applied with respect to officials (directors, officers, trustees, etc.) of the foundation and parties who are related to such officials.

The imposition of a general prohibition of self-dealing, to be applied only to future transactions, would eliminate an unduly burdensome portion of the Internal Revenue Service's responsibility in auditing private foundations. Such a general prohibition would avoid the invitation to abuse now inherent in the present permissive standards and, coupled with strict sanctions for filing false information returns, would tend to be self-policing. Finally, the lessening of the opportunity to use charitable funds for personal purposes should speed the flow of funds into the charitable stream.

These suggested rules would introduce into the tax law the concept which is fundamental to the law of private trusts: it is better to forbid self-dealing and to strike down all such transactions rather than to attempt to separate those transactions which are harmful from those which are not by permitting a fiduciary (as is the donor when he is dealing with charitable funds) to justify his representation of two interests.

From the standpoint of society as a whole, little if anything would be lost if a general ban upon self-dealing were adopted and much would be gained. A private foundation, especially if it is in corporate form, is usually not limited to the "legal list" from which trustees must choose their investments. Since a foundation may choose from a wide range of possible investments, it is not necessary for it to invest in the business of its donor, or to lend him any money. Similarly, a party who engages in transactions with the foundation on a truly arm's-length basis could, by definition, engage in the same transactions, on the same terms, with strangers.

Accordingly, there appears to be no sound reason to allow donor-private foundation transactions. The imposition of a general prohibition of self-dealing properly limits the deduction for charitable donations to only those situations in which the donor has completely parted with the donated property and thus has committed it without reservation to charitable purposes.

B. DELAY IN BENEFIT TO CHARITY

(*1*) *Introduction*

Under existing law an immediate deduction is allowed for gifts to both operating[3] and nonoperating private foundations. In the case of contributions to operating foundations, an immediate deduction is considered appropriate because the funds generally find their way into the charitable stream within a short period after they are received by the foundation. Thus the delay between the loss of tax revenue and the benefit which accrues to the public from having an equivalent amount of funds devoted to an active charitable program is often not substantial.

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[3] The Revenue Act of 1964 contains special rules for "unlimited gifts" to private operating foundations For the purpose of such rules a private operating foundation is defined as a privately supported organization which has substantially more than one-half of its assets directly devoted to active charitable activities (sec. 170(g)(2)(B)). Such an organization must also expend substantially all of its income for charitable purposes on a current basis. This definition could also be used to distinguish between operating and nonoperating private foundations for purposes of this section.

Contributions to nonoperating foundations, however, are often neither devoted to an active charitable program nor distributed to operating charities. Instead, such contributions are often retained by the foundation as principal, to be used to generate income which is to be distributed to operating charities as it is received. In such cases there is usually a significant lag between the time of the contribution, with its immediate effect upon tax revenues, and the time when the public benefits by having an equivalent amount of funds devoted to charitable activities.[4] Many assert that the value of having a source of uncommitted funds which can easily move from one charitable area to another outweighs this delay. Under this approach it is sufficient if the private nonoperating foundation invests the contributions which it receives in assets which generate a reasonable amount of income and distributes such income to operating charities on a reasonably current basis.

Where, however, a nonoperating foundation invests its funds in assets which do not generate a reasonable amount of current income or retains the income generated by its investments (except for situations in which income is accumulated for a specific charitable purpose), the justification for the present treatment does not apply. In such a case the need for corrective action is evident.

While the causes of undesirable delay in benefit to charity are closely related, they can be more easily identified if they are examined separately. Therefore, this section of the Report will first consider whether existing law relating to the withholding from charity by private nonoperating foundations of their current realized income is adequate. The discussion will then proceed to a consideration of the desirability of rules which would deal with situations in which the managers of a private nonoperating foundation invest the foundation's funds in non-income-producing assets.

(2) *1950 legislation—existing law*

The undesirable delay in benefit to the public which results when a private nonoperating foundation is permitted to retain a substantial portion of its current income was recognized by the Congress when it enacted the Revenue Act of 1950. In considering the problems which arise when a foundation is permitted to retain its income, the Ways and Means Committee expressed its view that—

> the tax-exemption privileges with respect to investment income should be restricted to that portion of the income which [foundations] demonstrate that they are using to fulfill their charitable, etc., purposes by actual distribution to charity as the income is received by them (H. Rept. 2319, 81st Cong., 40 (1950), 1950-2 Cum. Bull. 411).

The House in 1950 believed that the ability to accumulate income often delays the time when charity and hence the public can receive the benefits which preferential tax treatment is intended to foster. To eliminate this delay, the House version of the Revenue Act of 1950 would have generally taxed the portion of an exempt organization's investment income (excluding capital gains) which the organization did not currently distribute for the charitable purpose for which it was granted an exemption. One exception to this general rule would have permitted tax-free accumulations of current income to the extent such accumulations were placed into special 5-year trusts which specified the purpose for which the accumulated funds were to be used. Another exception would have allowed a tax-free accumulation equal to 1 year's investment income.

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[4] The delay in benefit to charity which is inherent where the contributed funds are retained as principal has led to suggestions that since charity must wait for its benefit, the donor's benefit—the tax deduction for the amounts which he contributed to the foundation—should also be delayed. The adoption of this proposal, which would generally require a private nonoperating foundation to expend its principal, is not recommended by the Treasury Department.

The Senate, although recognizing that some organizations had abused the privilege of tax exemption by accumulating large amounts of income, rejected the direct tax on accumulations favored by the House. Instead it adopted a rule requiring that information disclosing the extent of an exempt organization's accumulations be made available to the public.

In conference, the present rules were adopted as a compromise. These rules, which are now contained in sections 504 and 681 of the code, provide that exempt status shall be denied to an otherwise qualifying organization for the year that its accumulated income is—

(1) *unreasonable* in amount or duration,

(2) used to a *substantial* degree for purposes other than those constituting the basis for the organization's exemption, or

(3) invested in such a manner as to *jeopardize* the carrying out of the function constituting the basis for the organization's exemption.

The regulations implementing these provisions generally exclude a foundation's capital gains in determining whether its accumulated income is unreasonable.

(3) *Evaluation of existing law*

Fourteen years of experience have indicated that in this context standards such as "unreasonable," "substantial," and "jeopardize" are inadequate as well as difficult and expensive to administer. The lack of definite rules leads to uncertainty, not only in the minds of those charged with the responsibility of administering this provision, but also in the minds of foundation managers who are aware that departure from the uncertain path of "reasonable" accumulations may result in loss of exemption.

The difficulty in administering current law can be illustrated by a recent Tax Court case in which a foundation with a net worth of approximately $1,000 purchased a 34-acre tract of industrial real property for $1.15 million. This purchase was financed with advance rentals of $154,000 received from a lessee and by loans of $1 million. Since the foundation used approximately 80 percent of its income for the 5 years following the purchase of the property to retire its debt, the Service revoked the foundation's exemption ruling on the grounds of an "unreasonable" accumulation. However, the Service's revocation was reversed by the court which held that the accumulation was neither "unreasonable in amount or duration" nor used to any "substantial degree for purposes or functions other than those constituting the basis for such organization's exemption." *Shiffman* v. *Commissioner*, 32 T.C. 1073 (1959).

Another litigated case involved a foundation which was established to provide pensions to the employees of an investment company in which the donor was a minority shareholder. If the income generated by the donated assets would have been used to provide an immediate benefit to eligible employees, payments of approximately $15 per month could have been provided. To increase the benefits to $60 per month, the trustees decided to retain and add to corpus the income generated by the foundation's assets during a 10-year period. The Internal Revenue Service contended that such an accumulation was unreasonable. A Federal district court, however, felt that the accumulation of income for the purpose of increasing the amount of income which could be distributed for exempt purposes in the future did not constitute an unreasonable accumulation. *Truscott* v. *United States*, 58–1 USTC ¶9515 (E.D. Pa. 1958) (CCH). The reasoning of the court's decision has been interpreted by some as sanctioning a 10-year accumulation of income merely to increase the size of a foundation's corpus.

These court decisions, in effect, tend to frustrate the present ban on "unreasonable" accumulations except in the most blatant cases. They also indicate that existing law does not provide the results intended by Congress in 1950.

The survey of tax-exempt foundations recently completed by the Treasury Department indicated that in 1962 approximately one-fourth of all private foundations did not expend for charitable purposes an amount equal to their net ordinary income.[5] For example, the A foundation accumulated virtually all of its 1962 net ordinary income of approximately $600,000. The B foundation accumulated virtually all of its 1962 net ordinary income of $2 million. The C foundation accumulated approximately $900,000 of its 1962 net ordinary income of approximately $1.6 million. The D foundation accumulated approximately $1.3 million of its 1962 net ordinary income of approximately $2.5 million. The retention of income in situations such as these deprives the public of the benefit expected in exchange for the amount of current tax revenue which has been given up; namely, the expectation that an offsetting current charitable benefit would be provided by the foundation.

(4) *Possible solution*

(*a*) *Distribution of realized income.*—Because of the inadequacy of existing law and the Service's difficulty in administering the present permissive rules, it would be appropriate to adopt a rule which would give both taxpayers and the Service workable objective standards. It is therefore recommended that all private nonoperating foundations be required to distribute all of their current net income on a reasonably current basis. Such a requirement would insure that the interposition of a private nonoperating foundation between the donor and charitable activities will not result in undue delay in the transmission of benefits to their charitable destination.

Under this proposal a private nonoperating foundation would generally be required to expend the full amount of its current net income by the end of the year following the year such income is received. For this purpose income would include investment income such as rents, interest, dividends and short-term capital gains.[6] Long-term capital gains (including capital gain dividends paid by regulated investment companies) and contributions received by the foundation would not have to be distributed on a current basis. The purposes for which the income would have to be expended would be (1) contributions to publicly supported charitable organizations,

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[5] For these purposes net ordinary income was defined as total income (excluding capital gains) less expenses incurred in earning such income.

[6] Net income would be total income after deduction of expenses of earning such income. Current operating expenses would be treated as a current expenditure for charitable purposes.

(2) contributions to privately supported operating organizations (but not privately supported nonoperating organizations), (3) direct expenditures for charitable programs, and (4) purchases of assets which the foundation uses as part of its program of charitable activities.

This proposal is illustrated by the following example: In 1966 the X foundation received dividend and interest income of $100,000, realized a long-term capital gain of $50,000 and received contributions of $25,000. The foundation would be required to expend $100,000 for the purposes described in the preceding paragraph. This expenditure could be made in 1966 or 1967, or part in each year. However, if all or a part of the expenditure is made in 1967, such expenditure could not be treated as satisfying the expenditure requirement for that year. Thus, if the foundation made no distributions in 1966 but expended $100,000 in 1967, such expenditure could not be used to satisfy the expenditure requirement for both 1966 and 1967. Assuming that the foundation received investment income of $110,000 in 1967, the foundation would have to expend an additional $110,000 (making a total of $210,000) in 1967 or $100,000 in 1967 and $110,000 in 1968.

The allowance to private nonoperating foundations of an additional year after receiving income in which to make the necessary expenditures will permit such foundations to budget their expenditures and to investigate various uses for their funds before having to make the required outlays.

Two exceptions to this rule seem desirable. The first would allow a foundation to treat as an expenditure amounts which are set aside for a definite charitable purpose which the organization must identify at the time the funds are set aside, provided the purpose requires accumulation by the foundation for its accomplishment rather than, for example, by the intended charitable recipient. Such earmarked funds, however, would have to be actually expended within a specific period—such as 5 years—with an extension to be granted if the organization can demonstrate good cause.

A second exception would allow a private nonoperating foundation to accumulate its income to the extent that it had, during a prior specified period—such as 5 years—expended amounts in excess of its income for such period. This exception, which would act as an averaging mechanism, would allow a foundation to make an immediate gift to an operating charity out of corpus and recoup its expenditure out of future earnings. In an appropriate case, both exceptions could be combined.

A requirement that all private nonoperating foundations distribute their income on a reasonably current basis would be consistent with those provisions in the Revenue Act of 1964 relating to private nonoperating foundations which can receive unlimited contributions.[7] Such a rule would not require most foundations to change their existing distribution patterns. As noted above, approximately three-fourths of all foundations would have met the requirement suggested above in 1962. Some of the remaining one-fourth would have met the test if they were allowed to treat earmarked accumulations and charitable expenditures made in 1963 as distributions made in respect of 1962, as would be permitted under the recommendation discussed above. Of those who would not have met the requirement, many would have had to increase their charitable expenditures only by relatively small amounts. While this recommendation, therefore, would not affect the vast majority of foundations, its adoption would prevent extreme accumulation situations (unless they involved the exceptions noted above) such as those described earlier in this section.

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[7] The abuse which exists when a private nonoperating foundation does not distribute all of its ordinary income on a reasonably current basis was recognized by the Congress when it enacted rules dealing with unlimited contributions to such organizations. The approach contained in the 1964 act requires private nonoperating foundations receiving unlimited contributions to distribute not only all their income but one-half of such unlimited contributions as well. [Sec. 170(g)(3).] The recommendation explained above would not require a foundation to expend funds received as contributions.

(*b*) *Income equivalent.*—The ability of foundation directors to withhold current charitable benefits from the public merely to build a larger fund of capital—even though the purpose of the accumulation is to increase the amount of income which the foundation will receive (and distribute to charity) at some date in the future—constitutes an abuse. The recommendation described above is designed to eliminate this abuse when it takes the form of a direct accumulation—the building up of corpus out of retained interest, rents, dividends, and so forth. However, that recommendation in itself will not prevent foundation officials from engaging in indirect accumulations—the building up of a foundation's capital by investing in or retaining assets such as unimproved real estate, growth stocks and other assets which may not generate substantial amounts of current income but which often compensate for the forbearance of current income in the form of future capital appreciation.[8] The ability to increase the size of a nonoperating foundation's corpus by withholding a current benefit from the public is as much an abuse when it takes the form of an indirect accumulation as when it takes the form of a direct accumulation. In order to eliminate the problems in this area, therefore, it is also necessary to prevent indirect accumulations.

To insure that all private nonoperating foundations provide at least a minimum current benefit to charity it is recommended that there be established a "floor" below which the current benefits provided by the foundation to the public would not be permitted to drop. Such an approach could provide that if a private nonoperating foundation's income, and therefore its required payment to charity under the direct-accumulation proposal, falls below a specified percentage of the value of its holdings, the foundation would have to pay to charity, from its corpus, an amount which would approximate the income which it would have received had it invested its funds in the type of assets held by comparable organizations. If the foundation's current income (and therefore the amount required to be distributed to charity) exceeded this income equivalent, no distributions out of corpus would be required. Thus, the combination of the direct accumulation and the indirect-accumulation proposals would generally require a private nonoperating foundation to currently distribute its actual ordinary income or the foundation's "income equivalent," whichever is higher.

The minimum level of charitable expenditures—i.e., the income equivalent—should be comparable to the yield on investment funds held by comparable organizations—such as universities. To provide for changing market conditions, the Secretary of the Treasury should be given regulatory authority to determine this rate on an annual basis. Based upon existing market conditions, it would appear that a reasonable income equivalent would be in the range of 3 to 3½ percent.

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[8] It has been suggested that assets such as growth stocks increase in value faster than income securities and therefore will, in the long run, produce more income for charity than income securities. Recent stock market history, however, has indicated that all growth stocks do not necessarily increase in value faster than blue-chip income securities. Moreover, even if growth stocks do increase in value faster than income securities, the proceeds which the foundation would receive upon the disposition of growth stocks would usually represent long-term capital gains which could be retained by the foundation under the direct-accumulation proposal. Finally, even if growth stocks do increase in value faster than income securities and the trustees of the foundation distribute the proceeds from the sale of the growth stocks to charity, the benefit to charity would be delayed until some indefinite date in the future when the trustees decided to sell the appreciated growth stock. This indefinite postponement of benefit to charity is inconsistent with the principle that charity should receive some current benefit from gifts made to private nonoperating foundations.

The income equivalent would only be applied against a foundation's investment assets.[9] It would not be applied against assets which the foundation uses for its own charitable program. Assets which can be valued by reference to regularly available sources, such as quotations on a stock exchange or in an over-the-counter market, would be valued at their market value at the beginning of the foundation's annual accounting period. For other assets it will be necessary initially to use the value of the asset at the time it was acquired by the foundation. In the case of contributed assets, this value will be the same as the amount claimed by the donor as a contribution deduction. However with the passage of time such value is typically less than market value where the foundation continues to hold the asset. Therefore it will be necessary to revalue such assets periodically—perhaps every 5 years—and to use the value determined at such time until the next required revaluation. By using the market value as of the beginning of the year for assets which can easily be valued and a relatively constant value for all other assets, a foundation would always be able to determine well in advance of the end of its accounting period the amount which it would have to expend.

An exception for situations in which the foundation wishes to set aside its income equivalent for a definite charitable purpose which it can identify at that time should also be adopted. Such an exception would be similar to the exception suggested earlier with respect to accumulations of realized income.

Both the direct accumulation and income equivalent recommendations should apply to private nonoperating foundations which are presently in existence, as well as those created in the future. Existing organizations, however, should be permitted a reasonable period in which to adjust their investments in order to avoid having to spend corpus to satisfy the income equivalent requirement.[10]

It is recognized that the income equivalent proposal does not provide an adequate solution in all cases.[11] The fact that this proposal does not always assure that charity will receive a current benefit merely points out the need for special rules, such as those recommended in parts II(D) and III(A) of this Report, where the asset contributed to the foundation often does not generate any current income.

The two approaches described in this section are complementary and both are needed to prevent inappropriate delay in charitable benefits. These recommendations, together with those dealing with the treatment of specific types of assets, would provide a moderate and generally effective solution to the problems in this area. The combination of these approaches would impress upon the trustees of foundations the principle that fiduciaries should not ignore the present needs of charity in favor of concentrating on an increase in the size of the fund under their control merely to provide for some unnamed cause at some indefinite time in the future. These approaches would go far in reminding trustees that foundations are expected to provide a source of current funds for charity and that they should not be used as vehicles to further delay the flow of funds from the original donor to operating charities.

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[9] The income equivalent would not be applied against assets with respect to which, under the recommendations set forth in subsequent portions of this report, the donor's contribution deduction has been postponed.

[10] Provisions for existing organizations whose underlying instruments require an accumulation of current income or prohibit an invasion of corpus may be desirable.

[11] For example, one asset may provide enough income to completely shelter a nonincome producing asset. In such a case charity would only receive funds generated by the income producing asset. Charity would not benefit from the nonincome producing asset, even though the public has paid for the receipt of that asset through a contribution deduction.

C. FOUNDATION INVOLVEMENT IN BUSINESS

(*1*) *The existing situation*

A number of private foundations have become deeply involved in the conduct of active business enterprises. Ordinarily, the involvement takes the form of ownership of a controlling interest in one or more corporations which operate businesses; occasionally, a foundation owns and operates a business directly. Interests which do not constitute control may nonetheless be of sufficient magnitude to involve foundations in the affairs of businesses.

> *Example 1.*—The A foundation holds controlling interests in 26 separate corporations, 18 of which operate going businesses. One of the businesses is a large and aggressively competitive metropolitan newspaper, with assets reported at a book value of approximately $10,500,000 at the end of 1962 and with gross receipts of more than $17 million for that year. Another of the corporations operates the largest radio broadcasting station in the State. A third, sold to a national concern as of the beginning of 1965, carried on a life insurance business whose total assets had a reported book value of more than $20 million at the end of 1962. Among the other businesses controlled by the foundation are a lumber company, several banks, three large hotels, a garage, and a variety of office buildings. Concentrated largely in one city, these properties present an economic empire of substantial power and influence.
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> *Example 2.*—The B foundation controls 45 business corporations. Fifteen of the corporations are clothing manufacturers; seven conduct real estate businesses; six operate retail stores; one owns and manages a hotel; others carry on printing, hardware, and jewelry businesses.
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> *Example 3.*—The C foundation has acquired the operating assets of 18 different businesses, including dairies, foundries, a lumber mill, and a window manufacturing establishment. At the present time it owns the properties of seven of these businesses. Its practice has been to lease its commercial assets by short-term arrangements under which its rent consists of a share of the profits of the leased enterprise. By means of frequent reports and inspections, it maintains close check upon its lessees' operations.
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> *Example 4.*—The D foundation owns a crude oil refining company to which it assigns a book value in excess of $32 million.
>
> *Example 5.*—The E foundation controls a corporation which operates a large metropolitan department store. For its fiscal year ended January 31, 1963, the store reported gross sales of $78,395,052, gross profit of $32,062,405, and paid wages and salaries of $17,488,211. It stated the book value of its assets at that time to be $55,091,820.
>
> *Example 6.*—Among the business interests owned by the F foundation is a substantial holding in a corporation which constructs machines for the manufacture of concrete blocks. The corporation has approximately 800 employees; its annual sales have ranged from $12 to $15 million in recent years.

These striking illustrations of foundation participation in business are not isolated phenomena, peculiar to a limited group of very unusual private foundations. On the contrary, the available information indicates that the involvement of foundations in business activities is frequent. Of approximately 1,300 private foundations recently surveyed by the Treasury Department, about 180 reported ownership of 10 percent or more of at least one class of the outstanding stock of a corporation. One hundred and nine foundations in this group own 20 percent or larger interests;[12] 40 hold 100 percent interests. Forty-three foundations reported that they possess 10 percent or larger interests in two or more corporations. A recent report on foundations states that, of 543 foundations studied, 111 owned 10 percent or more of at least one class of stock of a corporation.[13] Together these 111 foundations held interests of not less than the described magnitude (most were in fact considerably larger than 10 percent) in 263 separate corporations. In other cases, of course, foundations own and operate businesses directly.[14]

(*2*) *Evaluation*

Examination of any broad sampling of the commercial ventures of foundations reveals that several kinds of undesirable results frequently follow from them. In the first place, taxable businesses are often placed at a serious competitive disadvantage. Congress recognized this problem in 1950, and, by the Revenue Act of that year, aimed at solving it. The statute which resulted subjects the so-called unrelated business income of foundations and certain other exempt organizations to tax at ordinary rates and removes the immunity formerly enjoyed by "feeder" organizations—entities primarily engaged in business, whose sole claim to exemption is the turning over of profits to exempt entities.

Fourteen years of experience under these rules, however, has demonstrated that organizations which pay careful heed to the exceptions prescribed by the 1950 act and retained in the 1954 code can frequently shield their commercial enterprises from tax. Because of the fact that the unrelated business income tax does not, for example, apply to rents derived from property with respect to which the lessor has no outstanding indebtedness, foundations are able to lease business assets owned free of debt to operating subsidiaries, siphon off most or all of the business profits by means of rent which is deductible by the subsidiary but not taxable to the parent foundation, and thereby accumulate large reservoirs of untaxed capital which can be used to support the future operations of the business. Another exception to the unrelated business income tax immunizes rents stemming from a lease whose term is not longer than 5 years even if the lessor has an outstanding indebtedness with respect to the leased assets. The C foundation, referred to in example 3, is typical of the private foundations which have tailored their acquisitions of businesses to make use of this exception. In the ordinary pattern of these acquisitions, the foundation contracts to purchase the stock of a business corporation for future payments, liquidates the corporation, leases its assets to a newly formed operating company for a 5-year term,[15] and applies the rents—usually fixed at 80 percent of the before-tax profits of the business—to the discharge of the stock purchase obligation. The ability of the foundation to receive the proceeds of the business operations in the form of tax-free rent enables it to pay a much higher price for the corporation than a nonexempt purchaser could afford.[16] A third and rather elaborate exception to the unrelated business income tax immunizes rental income which foundations realize in certain sorts of situations not qualifying for the first two exceptions.[17] All of these foundations compete with similar businesses owned by nonexempt taxpayers, who must pay for their acquisitions, finance their operations, and support their expansion programs with the funds which remain after taxes have been paid.

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[12] Further information about the business ownership of those of these foundations which have assets valued in excess of $10 million is set forth in Appendix A.

[13] Patman Report, 1st installment, supra, p. 8.

[14] The transfer of businesses to foundations and other exempt organizations has been encouraged by decisions of several courts that, under the arrangements ordinarily employed for these transfers, the transferors are entitled to treat the proceeds which they receive as capital gains. E.g., *Union Bank* v. *United States*, 285 F. 2d 126 (Ct. Cls.); *Anderson Dairy, Inc.* v. *Commissioner*, 40 T.C. 172; *Commissioner* v. *Brown* 325 F. 2d 313 (C.A. 9th). The Supreme Court now has under consideration the question of whether or not, after such a transaction, the former owners of the business receive capital gains treatment where the exempt organization makes no downpayment other than from the assets of the business itself, has no fixed personal obligation to pay a purchase price, and is required simply to turn over a specified proportion of the future earnings of the business. *Commissioner* v. *Brown*, *supra*, certiorari granted June 8, 1964. Whatever the outcome of that case, however, it seems clear that substantial inducements for the transfer of businesses to foundations will remain.

Moreover, even if the laws governing the taxation of unrelated business income of foundations and feeder organizations contained no avenues permitting business profits to escape tax, commercial enterprises conducted or controlled by private foundations would still possess significant competitive advantges over those owned by taxable entities. Because contributions to foundations may be deducted by the contributors for Federal income tax purposes, the capitalization of foundation businesses is accomplished with tax-free dollars, rather than after-tax dollars. A corporation which wishes to allocate $1 million of its gross earnings to the establishment of a taxable business subsidiary, for example, would be able to contribute only $500,000 of capital to the subsidiary after Federal income taxes have been paid; but the same corporation could create a foundation to operate the business, deduct its capital contribution, and have a full $1 million available for the business operation. Again, the tax immunity of dividends, interest, and other proceeds stemming from passive sources enables foundations to supply capital to their business endeavors with exempt income. Neither of these benefits is available to nonexempt commercial enterprises. Both benefits contribute materially to the ability of a foundation to subsidize its businesses during periods of difficulty and to expand them during periods of growth.

> *Example 7.*—When modernization of its textile mill facilities appeared desirable in 1958, the G foundation had sufficient funds available to make an additional $4 million capital contribution to its operating subsidiary.
>
> *Example 8.*—The H foundation has been able to sustain the operations of one of its department store subsidiaries with a 1956 loan of $1,400,000 (at 4½ percent interest) and a currently outstanding loan of $200,000 (which bears no interest).
>
> *Example 9.*—The I foundation has advanced more than $3 million to support the business of one of its foreign subsidiaries.

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[15] The foundation may or may not control the lessee corporation; the C foundation's practice is to lease to an independent corporation. In either event, the connection of the foundation with the business remains a close one. Since the lease bases the determination of rent upon the profits of the business, the foundation has a direct financial reason to be concerned with the conduct of the enterprise. Because of this interest, the foundation customarily reserves and exercises a right to maintain close supervision over the management of the business. The C foundation typically retains the additional right to approve the holders of a majority of the lessee's stock.

[16] Transactions of this kind have received widespread attention—and recommendation—in tax literature and other publications. See e.g., "Boosting Profits: Have You Put a Price on Your Business? You May Be Able To Double It—By Selling to a Charity," Prentice-Hall Executives Tax Report, June 24, 1963, p. 6; "Recent Cases Show How Best To Sell a Business to a Tax-Exempt Organization," Journal of Taxation, November 1963, p. 302.

[17] Internal Revenue Code of 1954, sec. 514 (b)(3)(B).

Example 10.—A recent report on foundations sets forth details of the numerous loans which the J, K, and L foundations made during the period from 1951 through 1961 to various of the business corporations in which they held controlling or substantial interests.[18] The total of this indebtedness on December 31, 1956, was $1,897,605. These foundations appear to have entered into at least 36 separate loan transactions with their corporations during the designated period, many involving sums in excess of $100,000.[19]

Another advantage which foundation businesses have over their taxable competitors is their freedom from the demands of shareholders for current distributions of earnings. A remarkable number of foundation-owned enterprises proceed from year to year realizing substantial profits, but making negligible or no distributions to their parent organizations.

Example 11.—The A foundation, referred to in example 1, received no dividends for either 1961 or 1962 from its newspaper corporation, its lumber company, or its S, T, or U real estate corporations, despite the fact that all of those companies earned substantial profits during both years.

Example 12.—The M company, a department store, entered its fiscal year ending in 1961 with a retained earned surplus of almost $4 million. During that year and the 2 following years it enlarged this surplus with earnings of $365,819, $193,450, and $149,320, respectively. It paid no dividends to its parent foundation during any of these years.

Example 13.—The dividends which the E foundation, referred to in example 5, has received from its department store subsidiary for the years 1960 through 1963 have ranged from less than 1 to 1½ percent of the book value of its equity in the corporation, as reflected on the corporation's February 1, 1962, balance sheet. In each of these years the store's after-tax net income has been considerably more than twice as much as the total dividends paid.

This common willingness of foundations to defer indefinitely the realization of profits from their commercial operations—an attitude frequently not shared by the shareholders of other businesses—makes it possible for the profits to be invested in modernization, expansion, and other programs which improve the competitive posture of the foundation-owned business.[20]

The various advantages of foundation-held businesses can make them formidable and successful competitors.

Example 14.—The X evening newspaper, owned by a foundation, has one competitor, the Z morning newspaper. Z has been in operation for a number of years and has very substantial financial resources. X, however, appears to have made competitive efforts which neither Z nor other newspapers of com-

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[18] Patman Report, 2d installment, supra, pp. 44–45.

[19] The recommendation of Part II-E(2) of this report—that restrictions be imposed upon foundation lending practices—deals with problems fundamentally different from that of unfair competition, and would have limited effect in the area of the present inquiry. Foundation loans to affiliated businesses could frequently be brought within exceptions to that recommendation (as, for example, private placements or obligations secured by first mortgages), and if, in a particular situation, the proposed limitations appeared troublesome, the foundation might well simply decide to furnish funds to its business by means of a capital contribution, rather than a loan.

[20] The requirement recommended in the preceding section of this report—that foundations make annual charitable disbursements at least equivalent to a prescribed percentage of the value of their assets—would not remove this advantage of foundation businesses. In many cases foundations will be able to comply with this requirement by making payments from contributions, income derived from nonbusiness assets, or proceeds arising from the liquidation of other holdings. Such foundations will have no greater reason to make demands upon their commercial subsidiaries for the distribution of business earnings.

> parable size elsewhere in the country have been able to duplicate. X utilizes seven wire services; other newspapers of similar size have from one to three. X publishes seven separate editions each day; Z publishes five; no comparable evening newspaper in the country publishes seven. X's normal subscription rate is $2 a month; Z's has been forced down to $2.25; those of newspapers in comparable cities range from $2.20 to $3. X recently purchased the only other evening newspaper in the city. Its advertising rates appear to remain substantially lower than those of any similar newspaper in the country.

In addition to having adverse effects upon competitors, foundation involvement in business may occasion other, equally objectionable results. Opportunities for abuses of the kind with which parts II A and B of this report deal specifically are frequently greatest where a foundation conducts or controls a business. Temptation for subtle and varied forms of self-dealing proliferate in such a situation. Remote relatives may be employed in the business; friends may be assisted; business acquaintances may be accommodated. However broadly drawn the restrictions upon self-dealing may be, many of the conflicts of interest arising in this area are likely to be sufficiently obscure or sufficiently beyond the realm of reasonable definition to escape the practical impact of the limitations. Making certain that none of the 800 employees of the F foundation's manufacturing business receive special benefits because of a relationship to one of the foundation's donors, or that none of the D foundation's $32 million oil refining business involves the transfer or use of money or property to or by parties related to the creator of the foundation, would entail enormous administrative burdens in itself, even if the danger of less definable abuses were not present.

Again, the problem of deferral of charitable benefits has been particularly pronounced in the foundation business setting. We have already noted the competitive advantage which foundation-controlled businesses commonly derive from the willingness of their owners to forego distributions of current profits. That same unconcern with the present realization of business earnings, manifested by many foundations, often delays the progress of funds to charity even when accumulation has no reasonable relation to business needs. The restrictions of existing law upon accumulations of income by businesses become operative only where a corporation is "formed or availed of for the purpose of avoiding the income tax with respect to its shareholders"; where the shareholders of the business are themselves tax exempt, the limitations may not apply. Similarly, the statute which prohibits unreasonable accumulations of income by foundations applies only to accumulations within the foundation itself; it does not prevent retention of earnings in a separate, though controlled, entity.[21] As a consequence, many foundations have permitted large amounts of income to accumulate in their business subsidiaries.

> *Example 15.*—In 1962 the Y foundation had amassed almost $9,700,000 of undistributed earnings in one of its business subsidiaries, and more than $5,800,000 in another.
>
> *Example 16.*—By the end of 1963 the O foundation had accumulated profits of $3,808,957 in its department store subsidiary.

When these funds will find their way to charity is, at best, a matter of conjecture. The moderate pressure provided by the payout requirement recommended in the preceding section of this report—which, after all, merely fixes a basic floor for foundation performance in distributions—affords only a partial solution to the aggravated deferral problem which exists in the foundation business context.

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[21] Even if the accumulation restrictions of existing law were extended to these situations, their enforcement would require an arduous, case-by-case examination of each separate set of facts.

The problem has another facet. A number of foundations have revealed a willingness to commit charitable funds to business operations which are failing or, at least, producing consistent losses.

> *Example 17.*—The P foundation continues a printing and lithographing business which lost $66,000 in 1959, $36,000 in 1960, $142,000 in 1961, $150,000 in 1962, and an additional amount in 1963.
>
> *Example 18.*—Twenty-four of the 53 business corporations controlled by the B foundation referred to in example 2, in 1956 lost money [illegible] that year, and most of those 24 showed net earnings deficits from previous years' operations. Fifteen of the 45 corporations which the foundation controlled in 1963 either had net losses in that year or had net operating loss carryovers to that year.
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> *Example 19.*—A construction subsidiary of the F foundation referred to in example 6, lost $22,920 in 1960, $17,133 in 1961, $41,023 in 1962, and $49,408 in 1963. At the end of 1962 the corporation's earned surplus account showed a net deficit of $199,818.

In all of these situations, charity bears the loss.

Participation by foundations in active business endeavors may also give rise to a problem of a different character. As the Introduction to this Report has pointed out, the private foundation is uniquely qualified to provide a basis for individual experimentation and the exercise of creative imagination. The framework of institutionalized charities can, in the nature of things, afford only limited scope for the development of individual insights, the testing of new approaches, the exploration of uncharted areas. But the private foundation—easily established, inherently flexible, and available even to those with relatively restricted means—can be utilized for precisely these ends. Indeed, many would argue that the private foundation derives the principal justification for the favorable tax treatment accorded it from its particular suitability for use by those who are concerned with, and devoted to the development of, new areas for social improvement. This special virtue of the foundation assumes that the individual or group in control will, in fact, be devoted to the development of these new areas; that the primary concern will be with social aims. But where a foundation becomes heavily involved in business activities, the charitable pursuits which constitute the real reason for its existence may be submerged by the pressures and demands of the commercial enterprise. The directors of a foundation which owns 26 widely diverse businesses must of necessity devote a very considerable portion of their time and energies to the supervision of business affairs; and charity's claim upon their attention may well suffer. Business may become the end of the organization; charity, an insufficiently considered and mechanically accomplished afterthought. Little may remain to distinguish the directors of such a foundation from the self-perpetuating management of a publicly owned business corporation, without the balance supplied by watchful shareholders. Unrestricted involvement in business may, then, undermine the very ability of the private foundation to make its unique contribution to our society.

It is quite true that, occasionally, beneficial consequences have stemmed from the business activities of a particular foundation. The Internal Revenue Service has, for example, discovered several instances in which foundation businesses have been profitable, their proceeds have been applied to charitable operations without undue delay, and private benefits for the foundation's donors or controllers have been avoided. In these situations it may well be true that charity has been advanced, and no one else harmed, by the ability of the foundation to carry on business endeavors.

On the other hand, the fact that the large majority of private foundations do not own businesses—and that their charitable endeavors suffer no noticeable disadvantage from the lack of business ownership—suggests persuasively that foundations have no real need to engage in business. Other sources of income and other kinds of investments, less inimical to the accomplishment of their charitable objectives, are available to them. Indeed, the Treasury Department has encountered widespread opinion, among foundations themselves and those familiar with their affairs, that business participation is altogether inappropriate for private foundations. Hence, the obvious, fundamental, and common abuses which attend the involvement of foundations in commercial endeavors would appear far to outweigh the minor and occasional benefits which particular foundations have sometimes derived from business ownership.

(3) *Possible solution*

For these reasons, the Treasury Department recommends the imposition of an absolute limit upon the involvement of private foundations in active business. Since effective control of a corporation very frequently resides in a body of stock representing 20 percent of its voting power,[22] and since ownership of a 20-percent interest almost necessarily entails close involvement in the affairs of the business whether or not the interest possesses control of the enterprise, it would seem appropriate to fix the limit at that level. This proposal would, then, prevent foundations from owning 20 percent or more of the total combined voting power, or 20 percent or more of the total value of the equity, of a corporation conducting a business which is not substantially related (other than through the production of funds) to the exempt functions of the foundation. A similar prohibition should apply to the ownership by a foundation, either directly or through a partnership, of a 20-percent or larger interest in the capital or profits of such a business. In determining the quantum of a foundation's stock or business ownership, interests held for the benefit of the foundation (whether by trusts, corporations, or others) should be attributed to it, but interests owned by donors, officers, directors, trustees, or employees for their own benefit should not.

Three carefully restricted forms of income production which are of a passive character should be excluded from the definition of "business." Except where active commercial lending or banking is involved, the earning of interest should not be considered to constitute a business. The holding of royalties and mineral production payments as inactive investments should be accorded similar treatment. Appropriate standards should be developed to identify leases of real property (and associated personal property) which are of a clearly passive nature; and rent arising from such leases should not be deemed to derive from the conduct of a business.[23]

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[22] Indeed, in special situations a much smaller share of voting power may constitute control. Large publicly held corporations may be controlled by blocks of stock which represent 2, 3, or 4 percent of the voting shares.

Rules similar to those of section 513 of the present Internal Revenue Code should be used to distinguish businesses which are substantially related to the foundation's exempt operations from those which are not. The three specific exceptions of section 513 should be continued: a business should not be considered unrelated if (1) substantially all of the work in carrying it on is performed without compensation; (2) it is carried on primarily for the convenience of the members, officers, or employees of the foundation; or (3) it consists of selling merchandise substantially all of which has been received as gifts or contributions to the foundation. Under the section 513 rules, a number of activities would fall beyond the ambit of the recommended prohibition. A foundation which solicits and receives as contributions old clothes, books, or furniture, for example, could conduct a business of selling those articles to the general public. A foundation engaged in the rehabilitation of handicapped persons could maintain a store to sell items made in the course of the rehabilitation training. Foundations would be permitted to operate cafeterias or restaurants primarily for the convenience of their employees.

Foundations should be afforded a specified reasonable period of time in which to reduce their unrelated business interests below the prescribed maximum limit. To provide flexibility to deal with situations in which the specified disposition period might work hardship, the Secretary of the Treasury should be given power to extend the period for a limited additional time in appropriate cases. Similar periods for disposition, similarly subject to extension, should apply in the future when a foundation receives a gift, devise, or bequest which involves business ownership beyond the permissible level. An exception to the general disposition requirement would seem advisable for existing foundations whose governing instruments, as presently drawn, compel them to hold specified business interests, if relevant local law prevents suitable revision of the controlling document. Foundations created in the future should, to qualify for tax exemption, be required to include appropriate prohibitions against business ownership in the documents under which they are organized.

D. FAMILY USE OF FOUNDATIONS TO CONTROL CORPORATE AND OTHER PROPERTY

(1) *Two widely practiced tax devices*

Foundations have commonly been established as convenient vehicles for maintaining control of a private corporation within a family while substantially diminishing the burden of income, gift, and estate taxes for the family. Two somewhat different techniques have been used to accomplish this result. Some taxpayers have contributed voting stock in a corporation which their family controls to a foundation which the family also controls. In this way, they obtain income- and gift-tax deductions for the donations, eliminate the impact of the estate tax upon the value of the contributed stock, and achieve tax-free transfer of dominion over the corporation to the younger members of the family by subsequently shifting control of the foundation to them. Other taxpayers have caused family corporations to be capitalized or recapitalized with substantial blocks of nonvoting stock. By contributing that stock to a foundation, the older generation secures the current income and gift tax advantages of the contribution and then transmits the voting stock—now representing a diminished proportion of the value of the equity of the corporation and, therefore, largely or entirely sheltered from gift or estate taxes—to the younger generation.

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[23] A specific exemption would also seem advisable for the incidental rental of assets (real or personal) used primarily in a foundation's charitable operations.

The availability of these devices has received widespread attention in tax and business publications. An excerpt from the May 7, 1960, issue of Business Week magazine (p. 153) is illustrative:

> *Have you ever thought about setting up a "family foundation"?*
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> * * * * * * *
>
> However, before you get serious, there are two prime questions: First, are there certain philanthropies (religious, educational, medical, etc.) that you'd willingly devote considerable time and money to in later years? And second, *do you have a sizable family business that you want to pass control of to your heirs, despite crippling Federal estate taxes?* If your answers are "yes," then a private foundation could be a way to give your "estate plan" an entirely new outlook.
>
> *What is a foundation?* It's a nonprofit organization with its own capital fund, that uses its resources solely for public welfare. It can be a State-chartered corporation, or a trust, or an unincorporated association. *If properly set up (with special Treasury-approved tax status) it pays no Federal taxes at all; yet it can be kept entirely under the control of its founder and his family.*
>
> *The real motive* behind most private foundations is keeping control of wealth (even while the wealth itself is given away).
>
> Take the typical case: Say the bulk of your property is in a family business. When you die, if you have a high-bracket estate, the estate tax could cause a forced sale of part or even all of the business—your children might lose control of the company, as well as have to sell their shares at a poor price.
>
> A foundation can prevent this. You set it up, dedicated to charity. *Year by year, you make gifts of company stock to it, until the value of your remaining holdings is down to the point where eventual estate taxes could be paid without undue strain, or until the foundation's holdings constitute firm control of the company.* You maintain control of the foundation while you live; you direct its charitable activities—and so, indirectly, you control the shares in your company that have been donated. When you die, control of the foundation passes from you to your family or other persons youtrust and thus they, in turn, keep reins on the business.
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> * * * * * * *
>
> [The italics are those of the original.]

Recurrent advice of this kind appears to have led many taxpayers to establish and utilize private foundations for the purposes suggested. The recent Treasury Department survey described in Appendix A disclosed a large number of foundations whose principal asset consists of stock in a corporation in which the foundation's donors, officers, or related parties retain substantial interests. Of the approximately 180 surveyed foundations[24] which hold 10 percent or more of at least 1 class of stock of a corporation, 121 reported ownership of family corporation stock.[25] Such ownership appears to be particularly concentrated among foundations of medium size—those whose total asset value is between $100,000 and $1 million. Of the 39 such foundations canvassed which have stock holdings of the noted magnitude, 32 own family corporation stock.

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[24] A total of approximately 1,200 foundations were covered by the survey.

[25] The term "family corporation stock" is used here in a sense consistent with the recommendation outlined later in this section. The situations to which the text refers, hence, are those in which both the foundation and a donor (and/or related parties) own stock in a given corporation and, together or separately, they hold at least 20 percent of the corporation's voting power.

Example 1.—The A foundation holds approximately 21 percent of the common stock of the A corporation, possessing a book value of more than $2 million. Substantial contributors to the A foundation and related parties own approximately 60 percent of the corporation's common stock.

Example 2.—By both inter vivos and testamentary transfers, the B foundation has received substantial holdings of the nonvoting common stock of two corporations which continue to be controlled by the B family.

Example 3.—The C and D foundations' principal donor owns all of the voting stock of the C corporation. Members of his family and he have given 106,000 shares of that corporation's class B nonvoting stock to the C foundation; they have given 80,000 shares of this stock to the D foundation.

(2) *Evaluation*

The use of private foundations to perpetuate family dominion over business creates situations which frequently contain, in their most aggravated form, problems of the sort which have been discussed in the preceding sections of this part. Plainly enough, the dangers of foundation involvement in business are at least potentially present in all of these situations. Moreover, because of the donor's retention of control over the dividend distribution policy of the corporation, the benefits which charity ought to receive from the contribution of stock to the foundation are frequently deferred indefinitely or absent altogether. Since the stock is closely held and ordinarily unmarketable, the foundation—even if it is not subject to the donor's influence—has little choice but to hold the shares and hope for dividends; and the donor often proves unwilling—or the corporation unable—to pay them. Yet, by arranging redemption of token amounts of the stock or by causing an atypical, but strategically timed dividend distribution, the donor may very well be able to sustain his claim that the stock has substantial value and entitles him to a large deduction on its contribution to the foundation.

Example 4.—The recent Tax Court case of *Pullman* v. *Commissioner*, T.C. Memo. Dec. 1964–218, affords an excellent illustration of these problems. The taxpayers there, in control of a clothing corporation, arranged the recapitalization of the corporation with 8 percent preferred stock, nonvoting common stock, and voting common stock. They then made gifts of the preferred stock to various relatives and donated large portions of the nonvoting common stock to a family foundation. They also donated small blocks of the nonvoting common stock to two independent charities, and had the corporation redeem these blocks shortly after the contributions at approximately book value. In its 19-year history the corporation had paid dividends of more than 8 percent only once: in 1959—which was one of the years in which a major contribution of stock was made to the foundation—8 percent was paid on the preferred stock and an additional 3 percent was paid on the nonvoting common stock. Nonetheless, despite the existence of the preferred stock, with its large prior claim upon the profits of the corporation and the consequent unlikelihood that the common stock would ever receive significant dividends, the Tax Court held that the trans-

> fers to the foundation qualified for charitable deductions only slightly smaller in amount than the book value of the transferred stock.
>
> *Example 5.*—Members of the A family claimed deductions of almost $2 million for their contributions of A corporation stock to the A foundation, referred to in example 1. The stock of this corporation paid no dividends from 1948 through 1957, and none for 1962 or 1963.[26] While small dividends were declared in the years 1958 through 1961, they appear to have produced less than $5,000 a year for the foundation.
>
> *Example 6.*—Beyond the immediate members of the B family, no market exists for the stock owned by the B foundation (referred to in example 2) in two family corporations, and the foundation has never received any dividend on either holding.
>
> *Example 7.*—In only 1 of the last 6 years have the C and D foundations, referred to in example 3, received dividends on their large holdings of nonvoting stock in a corporation controlled by their principal donor.

Extreme delay or entire absence of benefit to charity, then, is common in family corporation cases.

Also present in these cases—often with unusual severity and complexity—are the conflicts of interest characteristic of the self-dealing problems discussed in part IIA of the Report. Where the donor exercises decisive influence over both the foundation and the corporation, he faces difficult divisions of responsibility. When the corporation encounters financial difficulties, for example, his duty to the foundation may dictate efforts to dispose of its shares without delay; but liquidation of the foundation's interest may occasion adverse market consequences and thereby run counter to his obligation to other shareholders or his own self-interest.

> *Example 8.*—The E foundation suffered heavily from the divided loyalties of its creators and managers. In 1953 substantially all of its assets were invested in the preferred stock of a corporation 50 percent of whose common stock was owned by these persons. The corporation's prospects appear even then to have been far from bright. As matters grew worse, the foundation maintained its holdings. In 1962, at the time of the last available information, the preferred stock had never paid any dividends, the corporation was on the verge of bankruptcy, and the assets of the foundation had become virtually worthless.

The donor's retention of a personal interest in the corporation may place him at odds with the welfare of the foundation in other ways. If he is in a high personal tax bracket, he may wish to have the corporation accumulate its earnings so that he can realize his gains by future sale of his stock and confine his tax to the rate prescribed for capital gains; but the foundation may require present funds for its charitable program. He may wish the corporation to employ his relatives; it may be best for the foundation that they not be employed. The donor will generally find it in his interest to have the corporate salary levels of family members fixed as high as is consistent with the requirement of the tax law that deductible compensation be "reasonable," for it makes little difference to them whether they receive the earnings of the corporation as dividends or salary, and the corporation may deduct only the latter. The interest of the foundation, on the other hand, lies in keeping salaries as low as is consonant with the employment of competent personnel. The requirements of charity may dictate current expenditures by the foundation; the donor may be tempted to have the foundation retain its funds to meet the possible future needs of the business. In all of these situations it is unrealistic to expect the donor, as director of the foundations, to bring to bear upon problems which involve his personal interest the same judgment which an independent party, concerned only with the welfare of charity, would employ.

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[26] The foundation received its stock in the latter 1950's, 1960, and 1961.

Problems of the same nature arise where the donor contributes to a private foundation an interest in an unincorporated business, or an undivided interest in property, in which he or those related to him retain substantial rights. Current tax deductions have been claimed, for example, for contributions of rights in the air space over the donor's land, water rights adjacent to a private beach which the donor owns, or fractional interests in vacant land which the donor controls. Here again, because of the donor's close continuing connection with the property, it is hardly realistic to expect the foundation to make independent decisions about its use and disposition of the property.

While the abuses generated by family dominion over foundation property in many respects are similar to those dealt with by other portions of this Report, the problems here are sufficiently intensified, complex, and possessed of novel ramifications to require a special remedy. This Report elsewhere recommends that foundations be required to pay out annually at least a minimum approximation of a normal return upon their assets; but that requirement cannot obviate the need for foundations to have sufficient independent command over their assets to enable them to realize—whether by sale, conversion to more productive investments, or otherwise—the means to exceed the minimum when their charitable objectives demand it. Indeed, the payout rule may create pressures upon a foundation to liquidate other, useful assets in order to preserve its holdings of unproductive family corporation stock; or the rule may be satisfied simply by the donor employing the foundation as a conduit for his ordinary annual charitable giving—while charity continues to derive no benefit from the foundation's family corporation stock. Similarly, rules concrete enough to possess real efficacy in the prohibition of specific self-dealing practices cannot cope successfully and decisively with the subtle and continuing conflicts of interest which arise in the family stock situation. Finally, a foundation which is itself under the influence of a donor and which holds stock in a corporation controlled by the donor will, even where its stock holdings amount to less than 20 percent of the corporate equity, almost necessarily find itself involved in the business affairs of the corporation: for the foundation's stock will be used in combination with that of the donor and related parties to govern the commercial enterprise.

(3) *Possible solution*

To deal directly with the problems in this area, the Treasury Department recommends consideration of an approach which, for gifts made to private foundations in the future, would recognize that the transfer of an interest in a family corporation or other controlled property lacks the finality which should characterize a deductible charitable contribution. Under this recommendation, where the donor and related parties maintain control of a business or other property after the contribution of an interest in it to a private foundation, no income tax deduction would be permitted for the gift until (*a*) the foundation disposes of the contributed asset, (*b*) the foundation devotes the property to active charitable operations, or (*c*) donor control over the business or property terminates. If disposition, application to active charitable uses, or cessation of control occurs after the donor's death but within 3 years of the date of death, the deduction would be granted for the donor's last taxable year; if none of the three qualifying events takes place within that period, the contribution would not be deductible for income tax purposes. Correlatively, this approach would treat transfers of such interests, made at or before death, as incomplete for all estate tax purposes unless one of the qualifying events occurs within 3 years after the donor's death (or an extension of that period determined by the Secretary of the Treasury to be appropriate). Absent such a post-transfer qualification, the contributed asset would be included in the donor's gross estate and would not give rise to an estate tax charitable deduction. Such transfers, similarly, would not be deemed to constitute gifts, within the meaning of the gift tax statute, until a qualifying event occurs.

For the purposes of this recommendation, control of an incorporated business would be presumed to consist of ownership of 20 percent or more of the total combined voting power of the corporation; control of an unincorporated business or other property would be presumed to consist of ownership of a 20 percent or larger interest in it. The presumption could be rebutted by a showing that a particular interest does not constitute control. In determining whether or not the donor and related parties possess control, interests held by the foundation should be attributed to them until all of their own rights in the business or other underlying property cease. A qualifying disposition of contributed property by a foundation could consist of a gift to another organization, in harmony with the foundation's own purposes, or a sale; but it would not include a gift to another private foundation, since the donor could not have secured a deduction by making a direct contribution of the controlled interest to such an organization. An application of contributed property to active charitable operations would occur through the permanent and direct commitment of the asset to use in the conduct of the active charitable pursuits for which the foundation was organized, if it was organized for such pursuits. Water rights or land, for example, would be applied to charitable uses when they are employed in the activities of a foundation which operates a beach or a park. Because of the rule requiring attribution of ownership from the foundaton to the donor, a termination of control, in the relevant sense, could come about by a reduction in the holdings of either the foundation or the donor and related parties; but the termination would be recognized only where no offsetting reacquisition by one of the specified parties occurs within a prescribed subsequent period. The value of the contributed property at the time of disposition, devotion to charitable use, or cessation of control would determine the amount of the income tax deduction to which the donor would become entitled. The amount deductible for estate tax purposes would be the value of the property on the date of the donor's death or other governing date under the ordinary principles of estate tax law. If only a portion of the controlled property is disposed of or devoted to active charitable use, the donor would receive a deduction *pro tanto*.

Since they are designed to deal with different problems, the rule suggested here differs in a number of respects from the rule recommended in section C of this Part. The rule of section C would become operative where a foundation owns, in its own right, a 20 percent or larger interest in a business; the rule of the present section would be applicable even where the foundation's own interest in the business is less than 20 percent, if the total interests of the foundation, donor, and related parties constitute control. The two rules would overlap where a foundation has a 20 percent or greater interest in the business and a donor and related parties also have interests in it which, when combined with the foundation's ownership, amount to control. The rules would, however, have different consequences: the section C rule would require the foundation to reduce its ownership below 20 percent within a specified period of time; the section D rule would simply defer the donor's deduction for the contribution of an interest in the business until the foundation disposes of the contributed interest or donor control of the business terminates. The section C provision would apply both to the existing holdings of foundations and to those acquired in the future. The section D rule would apply only to contributions made to foundations in the future.

(4) *Possible restriction of this solution*

A possible modification of the proposal of the present section would postpone the donor's deduction only where, after the contribution, he and related parties control the business or other underlying property and, in addition, exercise substantial influence upon the foundation to which the contribution was made. Such a rule would permit an immediate deduction to a donor who transfers controlled property to a private foundation if he and related parties do not constitute more than a specified percentage of the foundation's governing body. Since many of the most troublesome problems in the family corporation-controlled property area are traceable to the conflicts of interests which result where the donor both dominates the corporation and has significant influence upon foundation decisions, this rule would confine the corrective measure to situations in which both of those elements are present.

The Treasury Department has analyzed this variation of the proposal with considerable care. Its examination of the matter has indicated that the modification would have the advantage of permitting immediate deductions in a limited number of situations in which gifts of controlled property to private foundations produce clear charitable benefits and appear to be accompanied by no concomitant abuses. On the other hand, two rather serious difficulties are inherent in the modification.

First, the task of achieving a satisfactory definition of "substantial donor influence" presents formidable problems. In proposing the imposition of a 25-year limit upon substantial donor influence over private foundations, Part II–F of this report suggests that a foundation be considered subject to such influence where a donor, members of his family, those with whom he has a direct or indirect employment relationship, and those with whom he has a continuing business or professional relationship compose more than 25 percent of the group which manages the foundation. The approach employed by this definition has a number of advantages over others which have been considered. Yet, as the discussion in section F recognizes, it leaves open significant avenues for the exertion of donor influence. By appointing friends, neighbors, business acquaintances, or other persons beyond the enumerated categories to the foundation's board, a donor may be able to elude the impact of the rule even while he maintains real and effective influence upon foundation decisions. The availability of these techniques for avoidance does not constitute a substantial defect in a rule whose aim, like that of the Part II–F proposal, is to broaden the base of participation in the affairs of the foundation, bring fresh views to its councils, and, over time, remove it from the wing of the donor and his family. Even where the newly appointed board members are the donor's friends and neighbors, some of these objectives are likely to be attained immediately. With the passage of time, others will follow: neighbors and friends do not remain subject to the will of one's family permanently. Equally important, a donor who has been permitted to shape the nature of a foundation by specifying the terms of its organizational instruments and supervising its activities for 25 years will ordinarily have little motivation to circumvent the rule: with the advance of age and the imprint of his personality firmly fixed upon the foundation, he will be quite likely to follow the easier course of taking the law at its word and passing the management of the foundation to independent parties.

The considerations which make this definition adequate for the purposes of the Part II–F recommendation, however, possess diminished vitality when one turns to the family corporation situation. Here the tax benefits to be derived from avoidance of the deduction-deferral rule are considerable; and the motivation for avoidance is correspondingly great. To sustain this rule against manipulation, therefore, a definition of "substantial donor influence" would have to be capable of bearing greater stress than the time limitation provision could be expected to generate. Because of its inapplicability to the less easily identified areas of donor influence, the definition of part II–F might prove only partially sufficient to withstand the pressures created by inventive planners. Further, as the preceding discussion has suggested, the conflict-of-interest abuses in the family corporation area have been acute and aggravated; and a measure which requires an indeterminate period of time to reach complete effectiveness might permit some of those abuses to continue in the interim. Upon both of these grounds, the adequacy of the Part II–F definition to the needs of the remedy under this section appears subject to some question.

A second problem confronts the restriction of the controlled property rule to situations in which the recipient foundation is under donor influence. While conflict of interest is one of the arguments in favor of the controlled property rule, it is not the only one. Of equal force is the argument that retention of donor control over the corporation whose stock has been contributed makes the real value of what has passed to the foundation too subject to the continuing volition of the donor, too far within his future discretion, too completely within his persisting power, to justify the grant of an immediate tax benefit.

Since the donor has not yet conferred a clear and definite present benefit upon charity—so the argument proceeds—he has done nothing to warrant a present tax deduction. To this contention—based, as it is, upon a considerable body of experience to the effect that charity very frequently benefits little or not at all from gifts of controlled corporation stock—the suggested modification provides no answer; for the donor's continuing power over the corporation exists whether the foundation to which he gives the stock is subject to his influence or not. To limit the impact of the remedial measure to gifts to influenced foundations, then, may confine the remedy to only a part of the abuse.

The existence of these problems does not compel the conclusion that such a limitation is unworkable. After deliberation, Congress may determine that the possibilities for avoiding the definition of donor influence are not serious. A somewhat stricter definition than that used in Part II–F—perhaps restricting the donor and related parties to a smaller percentage of participation in the foundation's governing body—may reduce those possibilities significantly. Consideration of specific instances of the controlled property abuse may lead Congress to conclude that the portion of the problem to which the restricted rule would apply is the portion of major practical importance, and that the disadvantage of the broader rule—which may, concededly, defer deductions in a limited number of situations where no abuse is present—outweighs the advantage to be achieved by seeking to cover the remaining part of the problem. The controlled property rule should not, however, be restricted to gifts to influenced foundations without complete awareness of the difficulties which that restriction may entail and without clear assurance that adoption of the restriction will cause no serious impediment to the operation of the rule itself.

E. FINANCIAL TRANSACTIONS UNRELATED TO CHARITABLE FUNCTIONS

Private foundations necessarily engage in a number of financial transactions connected with the investment of their funds. However, experience has indicated that unrestricted participation by foundations in three classes of transactions which are not essential to their charitable or investment activities can produce seriously unfortunate results.

(1) *Foundation borrowing*

The great majority of private foundations appear to borrow very little money. The Treasury Department's survey of the character and value of foundation assets and liabilities has disclosed that, at the end of 1962, while foundations held assets reported to have a total book value of approximately $10,713 million, they had total liabilities[27] of only $244 million. Borrowings, in other words, accounted for less than 2½ percent of total foundation assets.

On the other hand, a limited number of private foundations have borrowed heavily, for a wide range of purposes not related to the conduct of their charitable functions.

> *Example 1.*—In the years 1951 through 1962 the A, B, and C foundations, established and dominated by one person, borrowed

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[27] Other than liabilities with respect to grants payable. The latter class of liabilities does not, of course, represent borrowing in any usual sense of the term.

money from 17 different institutions and a variety of individuals to acquire investment assets. On December 31, 1956, the total outstanding indebtedness which the foundations had incurred for this purpose appears to have been approximately $14,200,000. A recent report indicates that, during the 12-year period covered, the foundations entered into 130 separate investment borrowing transactions. Many of the transactions involved amounts of more than $100,000; several involved more than $1 million.[28]

Example 2.—The D foundation has also engaged in extensive borrowing. On March 29, 1957, the foundation borrowed $550,000 from a trust company at 4½ percent interest and used the proceeds to make a loan of the same amount to a corporation at an interest rate of 10 percent. On November 18, 1957, the foundation borrowed $450,000 from a trust company at 4½ percent interest to make a $500,000 loan to two corporations at 10 percent interest. A three-page schedule in a recent report on foundations lists the other borrowing transactions into which this foundation entered from 1951 to 1962 to obtain funds for investment.[29]

Example 3.—In one jurisdiction a number of foundations, organized with little or no capital funds of their own, have carried on extensive practices of purchasing oil payments with funds borrowed from banks. Liens on the oil payments secure the loans. The foundations retain, as their fee for acting as intermediary, the excess of the gross proceeds of the production payments over the principal and interest required to be paid to the banks. The E foundation is typical of this group. Organized in 1954 with no funds of its own, E had by 1961 incurred indebtedness of more than $14 million in connection with its oil payment transactions. Its net income from these ventures was $58,352 in 1959 and $68,510 in 1960.

Example 4.—A foundation involved in recent Tax Court litigation was established in 1948 with a $1,000 contribution. Its net worth remained at approximately that figure until 1951. In the latter year the foundation contracted to purchase a 34-acre tract of industrial real property for $1,150,000, and borrowed virtually all of the purchase price. Leasing the property back to the former owners and 11 other tenants under an arrangement carefully fashioned to protect all of its rental proceeds from tax, the foundation was able to discharge its purchase obligation in 5 years. In that span, therefore, the foundation had expanded the value of its holdings from a thousand dollars to more than a million dollars—without the necessity of seeking or receiving contributions. *Shiffman* v. *Commissioner*, 32 T.C. 1073.[30]

Example 5.—The F foundation typifies the private foundations which have acquired productive properties by means of so-called bootstrap transactions. In their usual form, F's bootstrap acquisitions have consisted of an agreement by the owners of productive property to transfer the property to the foundation for a price payable entirely, or almost entirely, from a specified share of the

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[28] Patman Report, second installment, supra, pp. 46–47, 54, 59.

[29] Patman Report, second installment, supra, pp. 61, 63–65.

[30] In the cited litigation the Tax Court upheld the foundation's claim to exemption against the Government's contention that, in applying approximately 80 percent of the rental proceeds from the property to the satisfaction of its loan obligation, the foundation had accumulated its income improperly.

> future earnings of the property. The foundation ordinarily makes little or no down payment from its own assets and has no independent personal obligation for the unpaid portion of the price: If earnings are insufficient to enable it to make the payments required by the contract, the transferors' only rights are against the property itself. The foundation contrives to realize the earnings in tax-exempt form, commonly by leasing the property to an operating entity under terms intended to shelter the rent from unrelated business income tax. The F foundation has employed this technique to acquire most or all of the underlying assets of 18 separate commercial enterprises.[31] By arrangements of this sort, other foundations have been able to swell their holdings without risk to themselves or dependence upon contributors.

Foundation borrowing to secure funds for investment may have several unfortunate consequences. In many of the transactions of this class, private parties are able to shift a substantial measure of the financial benefit of the foundation's tax exemption to themselves. A foundation which can amortize a purchase obligation with tax-free proceeds from the purchased property, and which therefore will be able to acquire the property with little or no expenditure from its own assets, can frequently be induced to agree to a much higher purchase price than a taxable buyer would accept. Indeed, in the typical bootstrap sale of productive property to a foundation, where the foundation has no personal obligation for the purchase price and the only security for payment is the transferred property itself, the only contribution which the foundation makes to the arrangement is its tax exemption. The seller, already possessed of complete ownership of the property and an unrestricted right to all of its future earnings, would not enter into the transaction at all if tax considerations were absent; and the foundation can have only marginal bargaining power. Quite naturally, the resultant agreement diverts to the seller—by means of an inflated purchase price or, where a lease-back is involved, reduced rentals—a significant share of the advantage which the foundation derives from its ability to receive the income produced by the property free of tax. In other situations, one who lends money to a foundation may be able to insist upon an abnormal interest rate because of the foundation's power to realize a greater net return upon the money than a taxable borrower could. In these ways, foundation borrowing for investment uses can deflect, to the personal benefit of private parties, a portion of the advantage which tax exemption was intended to produce for charity.

But, though a part of the benefit of its exemption may escape the foundation, much remains. The foundation, after all, will ultimately secure unencumbered ownership of the property if a bootstrap operation works; it will earn the differential between the proceeds of a production payment purchased with borrowed funds and the cost of the loan which provided those funds; it may realize substantial profit from securities purchased on margin. These facts are the source of a second—and basic—objection to foundation investment borrowing: It enables the foundation to convert its tax exemption into a self-sufficient device for the production of capital. By borrowing, the foundation can extend the function of its exemption beyond the protection of income stemming from charitable gifts; it can use the exemption to develop funds even where there are no charitable gifts. Commentators have referred to this activity as trading upon or capitalizing upon the tax exemption. The foundation which makes such use of its exemption can sever itself from reliance upon contributors and eliminate the healthful scrutiny of its purposes and activities which that reliance implies.[31] By this expansion of its exemption privilege to borrowed assets and this divorce from dependence upon contributors, the foundation begins a multiplication of its holdings which bears no relation to the community's evaluation of its charitable works; it embarks upon an extension of its economic empire which is limited only by the financial acumen and commercial skills of its managers. The foundation described in example 4, which began with a net worth of $1,000 and within 5 years had increased its domain to include a 34-acre tract of industrial real property worth $1,150,000, is an extreme, but not atypical, illustration of the consequences of unrestricted foundation borrowing for investment purposes.

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[31] While F has pursued a practice of leasing the acquired assets to operating organizations in which it has little or no direct ownership interest, the terms of the leases in at least many instances have given the foundation sufficient connection with the business enterprises to bring the arrangements within the scope of the business limitation recommended in Part II–C of this Report. The connection does not, however, appear to have been an indispensible element of the transactions: and appropriate modifications of the lease relationships would seem to make it possible for F to accomplish these acquisitions even if a restriction upon foundation participation in business were in effect. F has also used the bootstrap technique to acquire productive assets which were not parts of a business enterprise.

In 1950 Congress recognized the impropriety and danger inherent in such exploitation of the tax exemption privilege. Concerned with a proliferation of situations in which exempt organizations were purchasing commercial property with borrowed funds and utilizing future rents from the property to pay the purchase loan, both the House Committee on Ways and Means and the Senate Finance Committee offered the following observations:

> The fact that under present law an exempt institution need not use any of its own funds in acquiring property through leasebacks—borrowed funds may represent 100 percent of the purchase price—indicates that there is no limit to the property an exempt institution may acquire in this manner. Such acquisitions are not in any way limited by the funds available for investment on the part of the exempt institution. This explains why particular attention should be given to leasebacks which involve the use of borrowed funds. Where an exempt organization uses its own funds, expansion of its property holdings through the leaseback device must necessarily proceed at a much slower pace, H. Rept. No. 2319, 81st Cong., 2d sess., p. 39 (1950), 1950–2 Cum. Bull. 410; S. Rept. No. 2375, 81st Cong., 2d sess., p. 31 (1950), 1950–2 Cum. Bull 506.

To deal with the problem, the Revenue Act of 1950 provided, generally, for the taxation of a portion of the rent which foundations received from property acquired with borrowed funds. The measure (continued without material change in the present Internal Revenue Code) has proved to possess two defects. It has, first, been crippled by the presence of an exception which permits rents from leases whose terms are not longer than 5 years to be received without tax. The cases set out in examples 4 and 5 typify a growing body of transactions in which foundations have been able to frame their acquisitions of productive property to take advantage of this exception. More fundamentally, the 1950 provision suffers from the narrowness of its scope. Operative only where the property purchased with borrowed money is rental property, it affords no solution to the same problems of diversion of exemption benefits to private parties and financial empire building which exists where borrowed funds are invested in royalties, oil payments, securities, or loans.

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[31] It is, of course, true that many foundations ultimately develop funds of sufficient size to free themselves from reliance upon contributors. Foundations created by large testamentary gifts may never have to seek money from others. In all of these situations, however, the foundation's basic endowment stems from persons who have sufficient regard for its aims to give it property; its structure and purposes are framed or evaluated by those who have a direct economic concern in the matter. The bootstrap foundation, on the other hand, can be organized with little or no capital. It proceeds to grow from within, independent of outside review. Even though no member of the public ever has sufficient interest in any of the organization's endeavors to contribute to it, the personal motivations of its managers can, where investment borrowing is permitted, be enough to build it to very large proportions.

The recommendations made by other sections of this report will not provide satisfactory answers to these problems. The proposal to restrict the participation of private foundations in active business does not apply where the foundation's return from its investment is passive. Even if the purchased assets are business assets, when the foundation detaches itself from the conduct of the commercial enterprise by entering into a passive lease to an independently controlled operating entity, the abuses become essentially different from those with which the recommendation of Part II–C is designed to deal; and that recommendation is, properly, inapplicable. The lending proposal of the following section would leave substantial areas in which foundations could continue to make loans, without reference to the source from which the loaned funds stem. The income payout and income equivalent rules suggested in Part II–B are similarly, of little assistance here. Since the payout rule applies only to the net income of foundations, depreciation or depletion would ordinarily shield much of the profit of property purchased with borrowed funds from the thrust of the requirement. Further, under the report's recommendation the "income equivalent" would be determined by reference to a foundation's net equity, rather than its gross asset value; and, as a consequence, this rule also would have limited impact upon assets acquired with borrowed money.

Without supplementation, then, both existing law and other sections of this report would still permit dangerous abuses through foundation borrowing. To foreclose the continuation of these abuses and to forestall the development of new ones, the Treasury Department recommends that, for the future, all borrowing by private foundations for investment purposes be prohibited. This recommendation would not prevent foundations from borrowing money to carry on their exempt functions: it would have no effect upon borrowing to make gifts to other charitable organizations, to defray the expenses of active charitable operations, or to acquire assets for use in the conduct of such operations. It would not, again, apply to investment transactions which are already in progress. For the future, however, it would confine foundation investments to funds stemming from contributions or from income produced by contributions.[33]

A proscription of foundation investment borrowing would have no practical effect upon the activities of the great majority of private foundations; for, as has been pointed out, they have not borrowed to invest even when they were free to do so. Indeed, the fact that these foundations have found no difficulty in carrying on their affairs and accomplishing their objectives without investment borrowing constitutes convincing evidence that foundations need not borrow for such purposes. A number of persons familiar with the operations of private foundations have indicated precisely that view to the Treasury Department. To curtail abuses by the minority of foundations, however, legislative adoption of the recommended rule is necessary.

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[33] In doing so, the proposal would in the future, for private foundations, supersede both the partial attack upon this problem made in the 1950 legislation and the much-criticized 5-year exception embodied in that legislation. The business limitation proposed in Part II–C of this Report would require either disposition or appropriate modification of existing foundation leases which do not qualify as passive. A number of the leases now in effect which have been drawn to take advantage of the 5-year exception would be subject to this requirement.

(2) *Foundation lending*

Many private foundations put portions of their funds to use in the making of loans which are not secured by mortgages and not evidenced by government or other bonds.[34] While much of this lending represents altogether proper and legitimate investment of foundation funds, some does not.

Example 6.—The A, B, and C foundations, referred to in example 1, all controlled by a single individual, made many loans to that individual's friends and business acquaintances. On December 31, 1956, one businessman owed these foundations $6,571,448. At the end of the years 1951 through 1961 another owed the foundations amounts ranging from $1,193,000 to $2,057,000. The indebtedness of various other businessmen to the foundations was, on the dates noted, as follows:

Individual A, Dec. 31, 1954	$138, 000. 00
Individual B, Oct. 27, 1954	1, 519, 000. 00
Individual C, Dec. 31, 1961	39, 210. 00
Individual D, Dec. 31, 1962	80, 246. 92
Individual E, Dec. 31, 1962	39, 027. 50
Individual F, Dec. 31, 1953	247, 084. 75
Individual G, Dec. 31, 1962	54, 000. 00
Individual H, Dec. 31, 1962	50, 154. 32

The loans to these and other businessmen ordinarily arose through transactions in which the foundations purchased and carried (often for several years) large amounts of securities for the accounts of the borrowers. Where the documents recording the arrangements specified interest rates, the rates prescribed were sometimes as low as 3, 3½, or 4 percent. In other cases, however, the rates were higher; and in many situations the foundations were entitled to share in the profits of sales of the securities.[35]

Example 7.—The G foundation had the following loans to various individuals outstanding at the end of each of the indicated years:[36]

Year ending Dec. 31	Makers	Interest rate (percent)	Amount
1952	Individual L	4	$11, 600
1953	do	4	11, 050
1954	do	4	10, 600
1955	do	4	9, 400
1956	Individuals J and K	4	1, 111, 500
	Individual L	4	8, 800
1957	do	4	7, 900
1958	do	4	6, 200
1959	do	4	5, 000
	Individuals L and M	0	15, 900
1960	do	0	10, 300
	Individual L	4	4, 000
1961	Individuals L and M	0	3, 700
	Individual L	4	1, 000

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[34] Table 11 of the Statistical Appendix to the report presents information on the total amounts of various classes of foundation loans outstanding at the end of 1962.

[35] Patman Report, 2d installment, supra, e.g., pp. iv, 24-27, 29, 31, 32.

[36] Patman Report, 2d installment, supra, p. 12.

> *Example 8.*—The H foundation borrowed money from banks and used the proceeds to make loans to three trusts and several individuals. The borrowers were, in some instances, closely enough related to the corporate creator of the foundation to be within the ambit of the expanded self-dealing rules suggested in Part II–A of this Report; in other instances, no identifiable relationship appeared. The interest rates for most of the loans were fixed from 1 to 2 percent higher than the rates which the foundation was obligated to pay the banks. One loan, however, bore interest at only 3 percent, and another at 4 percent.

The facts surrounding these transactions make it evident that the fundamental motivation for at least most of the loans was not the desire to find a secure and profitable investment for charitable funds but, rather, the wish on the part of the foundation's managers to assist parties whom they had some particular, private reason to benefit. Yet, with the exceptions noted in example 8, the borrowers were beyond the reach of any administrable and reasonable self-dealing prohibitions and the benefits accruing to the foundation's managers or donors were sufficiently nebulous and removed from the loan transactions themselves to be difficult to discover, identify, and prove. The task of isolating and demonstrating private benefit or noncharitable purpose—the only avenues of attack open to the government under existing law—becomes arduous and uncertain when the interest rate and the other terms of the loan accord with the standards of ordinary commercial practice. The advantages to the borrower of such a loan by a foundation—and the corollary value of the favor done by the foundation to the director or donor who arranged the loan—can, nevertheless, be considerable. The delays, inconveniences, and formalities of applying for a bank loan can be eliminated; embarrassing questions can be avoided; the assurance that one's obligation resides in friendly hands can be secured.

Charity may suffer two very real detriments from the absence of an effective proscription against privately motivated foundation lending. Because the safety of the obligation is not among the primary considerations leading the foundation to make the loan, charitable funds can be put to unusual and unnecessary hazard. Indeed, the same personal considerations which impel the foundation director or donor to cause the loan will quite probably dissuade him from enforcing its terms with vigor and dispassion when collection difficulties arise. But whether or not the foundation loses money on a particular loan, the very fact that such loans can be made may lead foundation managers to a broad range of decisions which do not comport with the interests of charity. Funds may be retained in liquid form, rather than being placed in more productive investments, so that they will be available for lending when the occasion arises. Charitable programs may be rejected because they would draw too heavily upon lending capital. Expenditures for the charitable projects undertaken may be restricted parsimoniously for the same reason.

To free foundation assets from the dangers inherent in privately motivated lending and to protect foundation decisions from the improper pressures which the availability of such lending may generate, the Treasury Department recommends that, for the future, the loans of private foundations be confined to categories which are clearly necessary, safe, and appropriate for charitable fiduciaries. Loans made by foundations in pursuance of their exempt functions—such as loans to students—should, of course, be permitted. Similarly, foundations should be allowed to make bank deposits, loans which are evidenced by securities of a type regularly traded upon an exchange or in an over-the-counter market, loans to governmental units, loans fully secured by first mortgages upon real estate, and other loans determined, under regulations prescribed by the Secretary of the Treasury, to be of substantially similar quality and character.[37] Examples of loans of the latter class would be short-term loans represented by the marketable commercial paper of prime borrowers and loans forming parts of sound private placements. Reference to the accepted lending practices of educational institutions and comparable organizations could furnish guidelines for the standards to be developed in the regulations. Beyond areas of the enumerated character, however, lending by private foundations ought to be prohibited.

(3) *Trading and speculation by foundations*

Certain private foundations have engaged in active trading of securities or have participated in speculative investments.

> *Example 9.*—The A, B, and C foundations carried on lively, extensive, and often speculative securities dealings. They entered into puts and calls, purchased a large volume of unlisted securities, and frequently acquired stock on margin. They agreed to a number of arrangements under which they carried securities for the accounts of individuals in exchange for the right to share in any profits which might be realized upon disposition of the securities. They sometimes sold stock within a period of from one to several days after acquiring it.[38]
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> *Example 10.*—The I foundation reported securities sales in 1963 which amounted to a turnover of approximately 20 percent of its stockholdings in that year. A recent Securities and Exchange Commission report[39] indicates average rates of turnover for foundations to be from 1 to 2 percent. All but four of the positions liquidated by the I foundation's 1963 sales had been purchased by the foundation after 1960; approximately half had been held for less than 6 months. The foundation realized a total gain of $2,342,067 from the sales.
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> *Example 11.*—The J foundation invested in a syndicate formed by several taxable corporations to purchase a ranch, hoping to profit from a sharp rise in land values which might take place if an adjacent city happened to expand in the direction of the property. The urban expansion did not occur. The syndicate operated the ranch at a loss for several years, and finally disposed of it. The foundation sustained a substantial loss on the transaction.

While it is difficult to assemble information upon the precise extent of trading or speculation among private foundations, the Treasury Department has encountered a substantial body of opinion, among persons familiar with the activities and practices of foundations, to the effect that the problem is of sufficient importance to require legislative attention.

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[37] Of course, where foundation lending activities constitute a business, the recommendation of Part II-C would become applicable.

[38] Patman Report, 2d installment, supra, e.g., pp. 23, 25, 26, 33, 34, 37, 38, 40.

[39] Securities and Exchange Commission Report of Special Studies of the Securities Market, July 17, 1963, pp. 864 and 1062.

Three kinds of dangers are inherent in foundation trading and speculation. Obviously enough, operations of this character ordinarily entail greater risk of loss than do prudently chosen long-term investments. Assets which have been committed to charity should not be subjected to that hazard. Conversely, these practices may be spectacularly successful; and where they are, they make possible both the financial empire building and the severance of a foundation from dependence upon contributors which have been criticized in the section of the Report dealing with foundation borrowing. A third danger is less obvious but equally significant. Foundation trustees or directors who attempt to predict hourly, daily, or weekly market fluctuations, who purchase puts, calls, and straddles in an effort to profit from those fluctuations, who shift their positions in securities frequently, and who endeavor to assay the potentialities of untried businesses, the worth of untested mineral land, or the future value of unproven building locations must necessarily expend considerable amounts of their time and attention in those endeavors. Little scope is likely to remain for charity. Charitable enterprises deserve—indeed, they require—analysis, evaluation, planning; they are not matters to be lightly undertaken or perfunctorily carried on; they merit the genuine interest and undivided attention of the persons to whom society has entrusted their accomplishment. Consequently, the efforts of the speculator or the trader—whether successful or unsuccessful—are intrinsically inconsistent with the proper management of the affairs of a foundation.

The present law on this subject contains several deficiencies. Section 504(a)(3) of the Internal Revenue Code proscribes investment of—

> amounts accumulated out of income during the taxable year or any prior taxable year and not actually paid out by the end of the taxable year * * * in such a manner as to jeopardize the carrying out of the charitable, educational, or other purpose or function constituting the basis for exemption under section 501(a) of an organization described in section 501(c)(3).[40]

One basic weakness of the section, of course, is that it applies only to income accumulations; it does not govern the manner in which corpus is managed. A second defect is that, by its reference to "jeopardy," the provision tends to make the success of a venture decisive of its permissibility: undertakings which turn out well are, with the benefit of hindsight, quite likely to seem sound, whatever risks they may have presented while they were in progress. Hence, the section affords only an imperfect device for dealing with the foundation which successfully utilizes trading or speculative practices to multiply its holdings and extend its financial domain. Third, as we have seen, speculation and trading entail an unfortunate consequence which has no relationship to the presence or absence of jeopardy: even where they involve no unusual hazards, they are likely to make greater demands upon the time, interest, and abilities of foundation trustees and directors than is consistent with the attentive and informed conduct of the affairs of charity. For this problem the present section 504 provides no solution.

In view of these considerations, the Treasury Department recommends that private foundations be directly prohibited from participating in any kind of trading or speculation with any of their assets, whether derived from corpus or from income. The prohibition should include specific interdiction of devices ordinarily deemed inherently speculative—as, for example, the purchase of "puts," "calls," "straddles," "spreads," "strips," "straps," and "special options," selling short, and trading in commodity futures.[41]

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[40] Section 681(c) contains a similar provision.

Like the borrowing and lending recommendations of the two preceding portions of the present section, this measure would exclude foundations from a class of financial transactions in which they ought not to be engaged. When combined with the business and self-dealing restrictions proposed elsewhere in the report, these rules would confine the unrelated financial activities of private foundations to areas which are appropriate for organizations whose assets have been committed to the advancement of the public welfare and whose concerns should be exclusively with the attainment of charitable aims.

F. BROADENING OF FOUNDATION MANAGEMENT

The Treasury Department's study of private foundations has revealed the existence of a group of interrelated problems which are at once more pervasive and more fundamental, but less concrete, less easy to identify, and less susceptible of isolation, than those with which the preceding sections of this Part have dealt. By their very nature, these problems evade precise definition and quantitative analysis. One cannot compile statistics which demonstrate their character and extent. In the main, one cannot report individual instances of their effect. For all of these attributes, however, they possess both reality and significance.

For the purposes of discussion, one may separate these problems into three general categories.

(*1*) *Abuse potentialities of donor influence*

The ability of a donor to wield substantial influence over the management of a private foundation which he has established or endowed presents continuing opportunities for the diversion of the foundation to purposes which are not wholly charitable. General prohibition of financial intercourse between donor and foundation, as Part II-A of this Report recommends, would, it is true, foreclose the most palpable abuses which have arisen in this area. Restrictions of foundation ownership of businesses and postponement of deductions for contributions of interests in controlled property would further reduce the possibilities for diversion and conflicts of responsibility. Nonetheless, the modes of human satisfaction have almost infinite diversity; and the ways in which wealth can be employed for personal advantage are, consequently, multiple and highly varied. Many donors, too, have manifested a common and deep-seated tendency to regard foundations which they have created as their own, to be availed of for their own ends where a contemplated use does not involve obvious and direct deflection of assets from charity and where no specific statutory prohibition lies in the way. Combination of these facts makes it difficult to escape the conclusion that real danger of abuse through substantial donor influence—albeit in forms less straightforward and apparent than those which have thus far occupied the attention of the Treasury Department and the Congress—will survive the restrictions proposed by other portions of this Report.

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[41] The suggestions advanced in Part II-E (1) above for the restriction of foundation borrowing would prevent margin purchases of securities.

Accurate appraisal of this problem is complicated by the fact that, as Part I of the Report has explained, the private foundation can derive important values from donor influence. The donor can bring imagination and creativity to the foundation, infuse spirit and drive into its operations, give unique focus to its efforts. But the fact that donor influence contains potentialities both for benefit and for detriment does not present a permanent dilemma: for its dangers and its values do not subsist equally throughout the life cycle of the foundation. While possibilities for abuse remain relatively unchanged, advantages tend to decline sharply with the passage of time. The donor can frame the fundamental structure of the foundation in its organizational documents; he can set the pattern for its activities and interests in the early years of its operations; he can establish its character by example, custom, and usage as it matures. Thereafter the magnitude of his contribution must, almost necessarily, diminish. In view of these facts, the present problem would seem capable of solution by a rule which confines substantial donor influence to the developmental and maturation stages of foundation life: such a rule would preserve the primary benefits of influence, and would eliminate a large measure of its possible detriments.

(2) *Perpetual existence of foundations*

A different, but related problem arises from the proliferation and perpetual existence of private foundations. By 1962 there appear to have been approximately 15,000 foundations in the United States. Current information indicates that an average of about 1,200 new foundations are being formed every year. The Foundation Library Center estimates that, of the foundations in existence in 1962, 72 percent of those with assets of less than $100,000 had been established since 1950, and 56 percent of those with assets of more than $100,000 had been created since 1950. Most of these foundations are established under organizational documents which place no limitation upon the period of their existence; and while satisfactory data upon foundation terminations is not available, it seems relatively clear that deaths are a good deal less frequent than births.

The continued existence of foundations whose number is constantly increasing generates a number of administrative burdens. Returns must be processed; questionable transactions must be investigated; compliance with legal requirements must be secured, sometimes through litigation. All of these activities cost the Federal Government considerable sums of money. Part I of this Report has explored at some length the reasons why, despite these facts, the imposition of a general limitation upon the lives of foundations is inadvisable. In specific situations, however, it may be far from clear that the perpetuation of an individual foundation justifies the attendant administrative burdens. It seems plain, at least, that many foundations continue in existence year after year without achieving any of the external indicia of unique advancement of philanthropy. They attract no public attention; their endeavors gain no public support; they appear to open no new areas, develop no new vistas, create no rearrangements or alterations of focus among charitable enterprises generally. Hence, while a universal restriction upon foundation lives is undesirable, a method of winnowing the useful from the superfluous—of evaluating the accomplishments, nature, and status of each private foundation at some point in its existence, with a view to a judgment upon the advisability of continuing it—would possess real utility.

Such a task would require a multitude of difficult and delicate value judgments, and should, therefore, not be undertaken by a governmental body without grounds considerably more pressing than those which obtain in the present situation. On the other hand, a foundation's creator, or those related to him, may not approach an endeavor of this kind with detachment. Consequently, satisfactory solution of this problem would seem to demand a rule permitting independent private parties to examine a foundation after it has had a reasonable period of time within which to prove itself. If their review leads them to conclude that the organization's record and capabilities do not justify its continuation, they should have power to wind up its affairs, distribute its assets in accordance with its purposes, and dissolve it.

(3) *Possibilities for narrowness of foundation management*

Under present law it is possible for an individual to establish a private foundation, dominate its affairs throughout his life, and pass its management to members of his family upon his death. In such a system supervision of the activities of a foundation may remain within the power of a very limited and homogenous group for an indefinite period of time; there is, indeed, no assurance that persons more broadly representative of the public will ever be introduced into the organization's governing body.

The disadvantages of the system are apparent. All of the dangers of narrowness of view and parochialism can persist in perpetuity. A foundation's motive force can, over time, become dissipated; and it is not guaranteed a source of replenishment. Attitudes may harden into prejudices; approaches may solidify; the responsiveness which this branch of philanthropy should have to the changing needs of our society may suffer. Projects which were useful and desirable when when they were undertaken may be continued long after they have become outmoded.

Recognizing the dangers intrinsic in narrowness of base, many of our colleges and universities take pains to secure personnel who have been trained at other institutions or who have drawn experience from different academic communities. Some of our great corporations have, in their hiring policies, manifested a consciousness of the same problem. Consequently, it would seem altogether inappropriate to permit this defect to insinuate itself into the management of one of the important areas of private philanthropy.

(4) *Possible solution*

To resolve these three problems, the Treasury Department recommends that provision be made to convert private foundations, after they have been in existence for 25 years, to management which is independent of their donors and parties related to donors. Without the harshness of requiring a complete severance of the donor from the foundation, this result can be accomplished by placing a limit upon the part which the donor and related parties can play in the management of the foundation. For several reasons, however, the fixing of the quantitative level of this limit requires some care.

The level should be set high enough to permit the donor significant representation on the foundation's governing body. On the other hand, imperfections necessarily inherent in the definition of the class of donor-related parties—parties who have sufficient connection with the donor to be likely to be subject to his influence—make it essential to confine donor participation to a relatively small percentage if effective prevention of substantial donor influence upon foundation decisions is to be attained. Administrative considerations make it impracticable to include, within the category of donor-related parties, more than the following: (1) members of the donor's family, (2) persons with whom the donor has a direct or indirect employment relationship, and (3) persons with whom the donor has a continuing business or professional relationship. Yet substantial areas of practical donor influence lie beyond the boundaries of this definition. Friends, neighbors, business acquaintances, and others may well be willing to accept the donor's judgment on matters pertaining to a foundation which he has established and whose assets he has contributed. Hence, if an approach is to be made to workable and effective prohibition of substantial donor influence over a foundation, the limit upon participation of the donor and related parties on the foundation's governing body should be fixed no higher than 25 percent.[42]

A rule which, after the first 25 years of the existence of a private foundation,[43] would prevent the donor and related parties from composing more than 25 percent of the managing board of the foundation would deal effectively with each of the three problems which have been described in the present section. It would limit the time period within which abuses could occur through the exercise of substantial donor influence; and, by assuring the donor that his actions would ultimately be subject to independent review, it would tend to protect the foundation from abuse even during its first 25 years. By enabling independent private parties to evaluate the performance and potentiality of the foundation after 25 years of operation and granting them power to terminate the organization, then or later, the measure would provide a method for eliminating foundation which have doubtful or minimal utility. Finally, in broadening the base of foundation management, the recommendation would bring fresh views to the foundation's councils, combat parochialism, and augment the flexibility of the organization in responding to social needs and changes.

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[42] Even with the limit upon identifiable donor representation set at this level, passage of control to independent parties may not be immediate. The donor may, for a time, be able to retain effective control through persons who do not fall within the definition of donor-related parties. But friends, neighbors, and others are unlikely to remain subject to the influence of the donor and his family indefinitely; and, with a 25-percent ceiling upon participation by more closely related parties, actual independent dominion over the foundation should ensue without undue delay.

[43] To avoid possible disruption of foundation affairs by requiring an abrupt, unanticipated change in management, foundations which have already been in existance for 25 years or more should be permitted to continue subject to substantial donor influence for an additional period of from 5 to 10 years.

PART III. ADDITIONAL PROBLEMS

In the course of its review of private foundations and the tax laws which apply to them, the Treasury Department has encountered several problems which, while possessing less general significance than the problems discussed in part II of the report, are sufficiently serious to warrant remedial action. Some donors have been able to secure substantial deductions for contributing to foundations assets which produce no benefit whatever for charity. Other donors have reduced their personal taxes by accomplishing tax-free bailouts of corporate earnings to foundations or by making contributions of other property which would have generated ordinary income upon sale. A defect in the computation of the estate tax marital deduction has permitted taxpayers unjustifiable enlargements in the tax benefits of bequests to their spouses through various devices involving foundations. Proper enforcement of reporting rules has been hampered by the absence of an effective sanction for failure to file the information returns required of foundations.

This Part of the Report sets forth illustrations of these problems, analyzes them, and suggests appropriate remedies.

A. CONTRIBUTIONS OF UNPRODUCTIVE PROPERTY

The Internal Revenue Service has discovered a number of situations in which very substantial income tax deductions have been claimed for contributions to private foundations of property which does not produce income and which the foundation does not, or cannot, devote to charitable uses.

> *Example 1.*—One taxpayer, for example, claimed a charitable deduction of $39,500 for the gift of family jewelry to her husband's foundation. The jewelry was placed in a safe deposit box listed in the name of the foundation, and at last report it has been held there for more than 6 years.
>
> *Example 2.*—Other taxpayers have secured significant tax savings by contributing paintings and other artworks to controlled foundations which do not maintain museums.
>
> *Example 3.*—A company donated vacant land adjoining its plant facilities to its foundation. During the 11 years for which the foundation held the property, it produced no income whatever.
>
> *Example 4.*—A man and his wife contributed the remainder interest in their personal residence to a foundation.

Difficult valuation problems frequently attend the donor's assertion of a right to a charitable deduction in these cases. More fundamental, however, is the criticism that the donor obtains a current tax advantage for a transfer which confers no concomitant benefit upon charity. The Government, in effect, pays the donor for his act; but the jewelry remains in the safe deposit box, the painting in the warehouse, and the land unused. As other portions of this report have noted, the presupposition of the tax statute is that the cost of the charitable deduction to the Government will be justified by its correlative benefit to charity. Here, plainly, the result is not worth the price.

The recommendations of other sections of this Report bear upon the present problem; but, designed to deal with difficulties of broader thrust, they do not provide an entirely satisfactory solution to it. A requirement that foundations disburse annually at least a minimum approximation of a normal return upon their property cannot convert an unproductive asset into a productive one. A foundation utilized as a conduit for its donor's normal annual charitable gifts may well be able to comply with this requirement year after year without ever being compelled to apply an unproductive asset to uses which benefit charity. Again, many contributions of unproductive property would appear to be made only because the donor has practical assurance that he will continue to enjoy the use of the property; and this Report's self-dealing recommendations, which would proscribe such use, might be expected to inhibit these contributions.[1] But the Internal Revenue Service should not be compelled to assign revenue agents to make certain that the jewels remain in the safe deposit box, or the painting in the storeroom, when their former owner entertains. And self-dealing rules can, by their very nature, have no impact upon those situations in which the unproductive asset is transferred to the foundation precisely because the donor has no further use for it. Hence, the Part II–A proposals will not, in themselves, be sufficient to eliminate abuses of the sort with which we are presently concerned. Similarly, while the rules suggested in Part II–D of the report cope adequately with the major abuses which have arisen through contributions of unproductive interests in property over which the donor maintains control (principally stock in controlled corporations), they do not apply to gifts of other kinds of unproductive assets.

Where property unproductive of income is transferred to a private foundation, the policy reason underlying the grant of the charitable deduction does not become operative until the asset is (*a*) made productive, (*b*) disposed of, or (*c*) applied to charitable uses. Consequently, the Treasury Department recommends that, with the limited exceptions described below, the donor's income tax deduction for such a contribution be postponed until one of those three events occurs. This measure would defer the deduction to the point in time at which it becomes justified, and, in addition, would resolve a number of complex valuation problems.[2] Rules similar to those explained in Part II–D in connection with the controlled property provision should, for this purpose, govern the definition of "disposition" and "application to charitable use"; the determination of the amount of the donor's deduction when he becomes entitled to one; and the length of the period within which qualification for a deduction could occur. An asset should be considered unproductive of income unless substantial income is regularly derived from it. Since the controlled property rule of Part II–D affords ample solution for the problems to which it applies and since, beyond the situations governed by that rule, there would appear to be little room for abuse through gifts of stock, evidences of indebtedness, or cash, these areas should be excepted from the proposed measure.

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[1] Sec. 170(f), added to the Internal Revenue Code in 1964, might also be expected to have this effect for similarly motivated donations of tangible personal property. That section provides that contributions of future interests in such property shall become deductible only upon the expiration of intervening rights held by the donor or related parties. Where the donor retains a real ability to use the contributed property, whether or not his power is set forth in any of the legal documents governing the transfer, the arrangement can be argued to constitute, in substance, the gift of a future interest. But the criticisms of the utility of the self-dealing rules in this area, explained in the text above, would seem to apply with equal force to the usefulness of sec. 170(f) here.

[2] Where the foundation sells the property, valuation would, of course, present no difficulty; where it makes the property productive, valuation should be easier; and where it does nothing with the property, valuation would never have to be undertaken.

For estate tax purposes, this recommendation would not require unproductive property which has been the subject of a completed inter vivos transfer to a private foundation to be included in the donor's gross estate; but it would permit the testamentary transfer of such property to a foundation to qualify for an estate tax deduction only under rules similar to those suggested in the controlled property section of the Report. Gift tax treatment would complement that prescribed by the estate tax statute: a completed lifetime conveyance of unproductive property would constitute a taxable gift, accorded a charitable deduction only upon the occurrence of one of the three qualifying events within a specified period after the transfer.

In its discussion of the problems presented by contributions of family controlled property, Part II–D of the report has indicated that valid arguments exist both for and against restricting the measure directed at those problems to the context of donor-influenced foundations. The problems of the present section are, in many ways, analogous to those of controlled property. Consequently, if the Congress concludes that it is desirable to limit the scope of the controlled property remedy to contributions made to donor-influenced foundations, it may also wish to consider such a restriction of the rules recommended in the present section.

B. CONTRIBUTIONS OF SECTION 306 STOCK AND OTHER ORDINARY INCOME ASSETS

(*1*) *Section 306 stock*

In 1954 Congress addressed itself directly and specifically to the problem of the so-called preferred stock bailout. Concerned with the obvious tax avoidance inherent in situations in which the shareholders of a corporation distributed preferred or other special stock to themselves as a tax-free dividend, realized capital gains upon selling this stock to a third party, and then had the corporation redeem the stock with earnings and profits—thereby accomplishing the distribution of corporate profits at the tax rate prescribed for capital gains—Congress determined to withdraw the favorable treatment accorded the earnings bailout. To that end, it adopted legislation providing, generally, that the amount which a shareholder realizes upon the sale, redemption, or other disposition of certain types of stock—designated "section 306 stock"—will be taxed to him as ordinary income. The typical situation covered by the legislation involves distribution of a preferred stock dividend to the holders of a corporation's common stock.

Since 1954 it has become apparent that, while this provision seals off avoidance possibilities for those who wish to sell or redeem section 306 stock, it does not foreclose the bailout device for taxpayers who contribute such stock to charity. Judicial authority has held that a person does not "realize" anything, within the technical meaning of the tax statute, when he makes a deductible charitable contribution. Hence, because the terms of section 306 become operative only where a disposition of stock occasions a "realization" for its former owner, they do not apply where the owner donates the stock to charity. As a consequence, a shareholder in a corporation which has substantial undistributed earnings can, without tax, receive a dividend of reredeemable preferred stock, secure a deduction for the full value of the stock by contributing it to a private foundation, and, if no prearranged plan for redemption exists, experience no tax consequences when the corporation redeems the stock from the foundation. The corporate profits have thus traveled a route leading from the corporation, through the shareholder, to the foundation; but the shareholder has never been taxed on them, and he has been able to reduce his taxable income by the entire amount of their value.

Indeed, if the stockholder is in a relatively high income tax bracket, he may well find significantly more cash in his pocket after the donation of section 306 stock to a foundation than he would be able to retain if he sold the stock for its full value. If, for example, a taxpayer in the 60 percent bracket sold section 306 stock for $20,000, he would pay a tax of $12,000 on the proceeds and be able to retain a net profit of $8,000.[3] If, on the other hand, he were to donate his stock to a foundation, his $20,000 deduction would diminish the tax which he would otherwise have to pay by $12,000. He would, then, be $4,000 richer if he gave the stock to a foundation than if he sold it.

The bailout potentialities of charitable contributions of section 306 stock have not escaped the notice of tax planners and advisers. A recent article in Taxes magazine describes the advantages to be derived from such contributions with clinical particularity. Rabinowitz and Dick, "Charitable Contributions of Section 306 Stock," Taxes, April 1964, page 220. Other articles describing the device are abundant.[4]

The Treasury Department's recent survey of private foundations suggests that a substantial number of taxpayers have made practical use of the often-repeated advice that the antibailout statute can be circumvented by giving section 306 stock to charity. Among the approximately 180 surveyed foundations which own 10 percent or more of at least 1 class of stock in a corporation, there are 74 separate holdings of what, from the reported information, appears to be section 306 stock.

The continued availability of the bailout device in the charitable contribution area has evoked criticism from a number of independent commentators. See Bittker, "Federal Income Taxation of Corporations and Shareholders" (1959 ed., p. 251). In its revised report of December 11, 1958, the House Ways and Means Committee Advisory Group on Subchapter C of the Internal Revenue Code of 1954 described the disposition of section 306 stock by donation to charity as an "abuse," and recommended that the problem be dealt with by reducing the donor's allowable charitable deduction by the amount which, under section 306, would have been taxed as ordinary income if the donor had sold the stock for fair market value. The working view developed on this subject by the American Law Institute Tax Project was to the same effect. 14 Tax Law Review 1, 5 (1958).

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[3] This example assumes that the stock's ratable share of the earnings and profits of the corporation at the time of distribution was at least equal to the proceeds of the sale.

[4] Cutler, "Various Aspects of Contributions to Charity," 17 New York University Annual Institute on Federal Taxation 1117, 1136 (1959); Lowndes, "Tax Advantages of Charitable Gifts," 46 Virginia Law Review 394, 413 (1960); Merritt, "The Tax Incentives for Lifetime Gifts to Charity," 39 Taxes—The Tax Magazine 104, 115 (1961); Quiggle and Myers, "Tax Aspects of Charitable Contributions by Individuals," 28 Fordham Law Review 579, 604–605 (1960); Ray and Oliver, "How to Choose Right Property and Method of Giving to Benefit from Gifts to Charity," 10 Journal of Taxation 118 (1959); Rudick and Gray, "Bounty Twice Blessed: Tax Consequences of Gifts of Property to or in Trust for Charity," 16 Tax Law Review 273, 280 (1961); Sugarman, "Charitable Giving Development in Tax Planning," 39 Taxes 1027, 1029 (1961); "Estate Planners Note: Contributions of Section 306 Stock Not Taxable," 7 Journal of Taxation 133 (1957).

The Treasury Department is of the opinion that the recommendation of the Ways and Means Committee Advisory Group is a sound one. Restriction of the charitable deduction which a donor receives on the contribution of section 306 stock to a private foundation[5] is consonant with the particular concern which Congress has, by the adoption of section 306, manifested for the earnings bailout problem. Measuring the reduction in the allowable charitable deduction by the amount of the ordinary income upon which the donor would have been taxed if he had sold the contributed stock makes the approach consistent with the provisions of section 306 itself. Furthermore, this approach is precisely that which Congress recently twice applied to analogous problems. In its 1962 enactment of section 1245 of the Internal Revenue Code, providing rules to insure ordinary income treatment of gain attributable to post-1962 depreciation of tangible personal and certain other property, and in its 1964 enactment of section 1250, prescribing rules of broadly the same direction for depreciable real property, Congress took care to specify that deductions for charitable contributions of such property should be diminished by the amounts which the new sections would characterize as ordinary income if the property were sold at fair market value.[6]

For these reasons, the Treasury Department recommends application of the Advisory Group proposal to contributions of section 306 stock to private foundations.

(*2*) *Other ordinary income assets*

When donors secure deductions for contributing to private foundations other classes of property which would have produced ordinary income upon sale, problems fundamentally analogous to those present in the section 306 stock context arise. Items includible in the donor's inventory and stock in collapsible corporations afford examples. In all of these cases the full amount of value which the donor would normally have had to include in his ordinary income is permitted both to escape taxation itself and to reduce the amount of his other taxable income. In many of these situations there exists the same anomaly pointed out above in connection with section 306 stock: the donor can make more profit by giving the asset to a foundation than he would have been able to retain if he had sold it.

Because of the basic similarity of the present problems to those generated by section 306 stock and because of the direct relevance here of the recent congressional action on the closely related ordinary income situations arising under sections 1245 and 1250, the Treasury Department recommends that the rule proposed for section 306 stock be applied to this area also. Under this recommendation, the income tax deduction accorded for the gift of any asset to a private foundation would be diminished by the amount of the ordinary income which the donor would have realized if he had sold the asset for fair market value at the time of the contribution.

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[5] The Advisory Group proposal is not limited to situations in which the recipient charitable organization is a private foundation: the group's recommendation would apply wherever a donation of sec. 306 stock gives rise to a charitable deduction. The American Law Institute Tax Project working view and Professor Bittker's discussion, similarly, treat the problem as one whose nature does not depend upon the character of the charitable organization involved. By its observation that the problem exists within the area to which the present report applies, the Treasury Department intends no implication that these views are in error.

[6] The American Bar Association in 1959 offered two objections to the Advisory Group proposal. Hearings on Advisory Group recommendations on Subchapters C, F, and K of the Internal Revenue Code, House Ways and Means Committee, 86th Cong., 1st sess., pp. 923, 931–933 (1959). One, advanced by some members of the Committee on Corporate Shareholder Relationships, was that the contribution of sec. 306 stock to charity represents only one facet of the broad problem presented by donations of appreciated property. The members who entertained this view were of the opinion that all aspects of the general question should be examined before action is taken upon any particular portion of it. This objection has, in a large measure, been undercut by the congressional decisions with respect to secs. 1245 and 1250. In both instances, Congress recognized that specific restriction of the charitable deduction affords an appropriate method of dealing with the problems posed by particular classes of assets. A second objection, made by other members of the Bar Association committee, was that the proper method of curbing abuses in this area is to grant a full charitable deduction for the donation of sec. 306 stock, but to tax the donor as though he had realized the entire fair market value of the stock at that time. Such a rule would be more stringent than that recommended by the advisory group: it would, like the Advisory Group proposal, cancel that portion of the donor's charitable deduction attributable to corporate earnings at the time of the distribution of the stock; but, in addition, it might occasion a capital gains tax where the stock has appreciated in value after its distribution to the donor. Without passing on the merits of this proposal, the Treasury Department is of the view that the less rigorous approach of the Advisory Group is sufficient to foreclose the sec. 306 stock abuse in the private foundation area.

C. CORRECTION OF COMPUTATION OF ESTATE TAX MARITAL DEDUCTION

When a donor makes an unrestricted contribution of property to a private foundation whose selection of charitable beneficiaries he has power to influence, he secures a current income tax deduction for the full value of the property. The existence of his power over the foundation confers an additional benefit upon him: under existing estate tax law, the value of the asset remains in the base upon which his marital deduction is computed.[7] Its presence in that base increases, by a sum equal to one-half the asset's value, the amount which the donor can bequeath to his wife free of estate tax—even while the asset itself escapes estate tax through the operation of the charitable deduction. On the other hand, the donor who contributes to a foundation over which he has no power receives no such enlargement of his marital deduction: the property which he has contributed does not bear upon his estate tax computations, and the tax advantage of his contribution is limited to the deduction provided by the income tax law.

This differentiation in the estate tax law between charitable donors who possess power to influence the foundations to which they contribute and donors who do not is quite inadvertent: it arises from the application, to the situation of the donor-influenced foundation, of principles designed to deal with entirely different problems. More significantly, it creates a preference which there is no reason for the tax laws to create. It establishes, through the mechanism of the estate tax, an artificial inducement, which has no necessary relationship to charitable inclinations or interests, for the retention of donor influence over private foundations.

Certain other sections of the estate tax law give rise to analogous incongruities. Under them, transfers which produce current charitable income tax deductions can be arranged to maintain sufficient donor involvement with the contributed property to increase the donor's marital deduction. The section dealing with life insurance has, in particular, been the subject of considerable manipulation designed to produce such double tax benefits.[8] The provisions governing retained life estates and transfers in contemplation of death may occasion similar problems.[9] In all of these situations, lifetime charitable transfers, treated as incomplete for estate tax purposes, gain an entirely unintended tax advantage over outright gifts.

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[7] Secs. 2036 and 2038 of the present Internal Revenue Code require that property transferred intervivos be included in the transferor's gross estate if he retains for life the power to designate the beneficiaries of its income or corpus. Both sections apply whether the transferor may exercise his power alone or in conjunction with other parties, and whether he possesses the power in a fiduciary capacity or not. Hence, in the usual situation, where at the time of his death a donor has a power to control or influence the decisions which a private foundation makes about the amounts and recipients of its distributions, all property which he has contributed to the foundation during his life would be required to be included in his gross estate. The so-called "adjusted gross estate"—which provides the base for the computation of the marital deduction—is determined from the gross estate without subtraction of the charitable deduction. As a consequence, the marital deduction base would include the value of the property contributed to the foundation. (The discussion here assumes that the contributed assets are not community property.)

[8] The effectiveness of the various life insurance devices has not yet been tested by litigation.

[9] The recommendation of Part III–A would postpone the income tax deduction for the gift of a remainder interest to a private foundation until the interest becomes possessory and productive or is disposed of by the foundation. By doing so, that proposal would, in the private foundation area, eliminate most possibilities for using retained life interests to achieve the described double tax benefits.

To remove these unjustified and incongruous tax preferences, the Treasury Department recommends that, where a donor secures an income tax deduction for the transfer of an interest in property to a private foundation, the value of the property be excluded from the base upon which his estate tax marital deduction is computed.[10] By placing contributions to donor-influenced foundations upon the same estate tax footing as those to foundations which the donor does not influence, such legislation would confine the tax reward for both classes of transfers to the income tax benefits which they were specifically intended to receive. Similarly, where the recipient charitable organization is a private foundation, it would eliminate the advantage which lifetime charitable transfers, framed to retain donor connection with the contributed asset, have over outright and unrestricted gifts.

D. SANCTIONS FOR FAILURE TO FILE INFORMATION RETURNS

To proceed with effective administration of the tax laws governing private foundations, the Internal Revenue Service must obtain completed copies of the annual information returns required of foundations. Unfortunately, not all foundations comply with the reporting rules prescribed by the Internal Revenue Code and the implementing regulations. While the Internal Revenue Service has taken what steps it can to cope with this problem—it has, among other things, undertaken the compilation of a master list of tax-exempt organizations which will permit use of automatic data processing equipment to facilitate identification of the nonfilers—its efforts have been hampered by the absence of an effective sanction for noncompliance.

Under present law, the willful failure to file any return required by law is a criminal offense. The penalty provided is imprisonment not exceeding 1 year and a fine not exceeding $10,000. This criminal penalty is the only sanction available in cases involving the failure to file foundation information returns. Plainly, its severity makes it inappropriate in most such cases.

To overcome this defect of existing law, the Treasury Department recommends that private foundations which fail, without reasonable cause, to make timely and complete filing of a required information return be subjected to a penalty of $10 for each day of delay beyond the prescribed filing date. The penalty should be subject to a maximum limit of $5,000. A similar penalty, with a similar maximum limit, should be imposed upon officers, directors, or trustees responsible for filing private foundation returns if, after notice from the Internal Revenue Service of failure to make a complete and timely return, they omit (without reasonable cause) to remedy the defect within a specified reasonable time. Measured by the seriousness of the noncompliance in individual cases and sufficiently moderate to be appropriate in situations not warranting criminal treatment, these sanctions would afford the Internal Revenue Service considerable assistance in securing adherence to private foundation reporting requirements.

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[10] Commentators upon the problems of the present section have treated them in a context wider than that of private foundations. By restricting its recommendation to the area of the present Report, the Treasury Department intends no implication that such views are in error.

APPENDIX A

Statistical Appendix

This appendix presents statistical estimates of the operation of the charitable contribution provisions of present law. It also contains information on the growth, the present size, and operations of foundations.

1. *Historical pattern of total contributions*

It is not easy to determine just what has been the effect of the tax provisions relating to charitable organizations. One would naturally look first at the size of the contribution deduction. This is summarized in table 1 for selected years.

The difficulty of year-to-year comparisons from the data in table 1 is the differing coverage of income tax returns in various years. In the 1920's, tax returns covered a far smaller portion of the population than they did in the 1950's. Also, when the standard deduction was introduced or increased, many contributors stopped listing contributions. But with any given standard deduction a smaller portion of taxpayers use it, more itemize each year, and thus itemized contribution deductions go up more than contributions.

Table 2 shows several long-term comparisons of the contributions of living individuals. So far as the tax-deductible contributions are concerned, the table shows the figures adjusted to include estimated contributions of nonfilers and of individuals using the standard deduction. These adjustments have been estimated by C. Harry Kahn for earlier years.[1] The 1956 and 1962 adjustments were made following Kahn's technique. To provide conceptual correspondence with estimated contributions received by operating charities, the table also includes charitable bequests and corporate contributions.

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[1] C. Harry Kahn, "Personal Deductions in the Federal Income Tax," National Bureau of Economic Research, Princeton University Press, 1960. Kahn's technique on nonfilers involved applying to their estimated income the ratio of contributions to income of the low-income filers. The estimate of contributions by standard deduction takers was based on changes in reported contributions at times when the standard deduction was expanded.

TABLE 1.—*Amount of charitable deductions on tax returns of individuals, corporations, and estates, selected years*

[Millions of dollars]

Year	Individuals	Estates [1]	Corporations	Total
1962	$7,516	(2)	(2)	(2)
1961	(2)	(2)	$512	(2)
1960	6,750	$951	462	$8,163
1958	5,694	669	395	6,758
1956	4,878	[3] 534	415	5,827
1954	3,891	398	314	4,603
1952	3,114	[3] 336	398	3,848
1950	2,260	274	252	2,786
1948	1,881	296	239	2,416
1946	1,639	186	211	2,036
1944	1,258	202	234	1,694
1942	1,450	155	98	1,703
1940	740	143	38	921
1938	414	200	27	641
1936	390	128	30	548
1934	280	146	27	453
1932	317	191	31	539
1930	434	223	35	692
1929	540	154	32	726
1924	533	116	(2)	649

[1] Estate tax deductions listed for the year in which the estate return was filed.
[2] Not available.
[3] Interpolated.

Source: "Statistics of Income," except corporations before 1936 which are taken from "National Income," 1954 edition, Department of Commerce.

TABLE 2.—*Estimates of contributions to charity, derived from donor and recipient reports, in relation to adjusted gross income, selected years 1924–62*

Year	Estimated contributions from donor reports					Estimated contributions from recipient reports		Adjusted gross income	Ratio of contributions to AGI based on—		
	Living individuals	Charitable bequests on estate tax returns	Corporate giving	Other, i.e., income from endowments including foundations	Total	Nelson	American Association of Fund Raising Counsel		Living individuals	Total contributions	
										Donor estimate	Recipient estimate
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
	Millions	*Millions*	*Millions*	*Millions*	*Millions*	*Millions*	*Millions*	*Billions*	*Percent*	*Percent*	*Percent*
1962	$9,843	(1)	(1)	(1)	(1)	(1)	$9.3	$385.0	2.55	(1)	(1)
1956	7,317	$534	$418	$627	$8,896	$7,458	6.5	309.0	2.37	2.88	2.41
1950	4,359	274	252	410	5,295	4,344	(1)	201.0	2.17	2.63	2.17
1945	2,762	192	206	262	3,482	2,625	(1)	140.0	1.97	2.49	1.88
1940	1,254	143	38	188	1,623	1,235	(1)	70.1	1.79	2.31	1.76
1935	828	106	28	148	1,110	1,018	(1)	48.4	1.71	2.29	2.10
1930	969	223	35	177	1,404	1,530	(1)	62.2	1.55	2.26	2.46
1929	1,084	154	32	(1)	(1)	(1)	(1)	75.6	1.44	(1)	(1)
1924	973	(1)	(1)	(1)	(1)	(1)	(1)	62.0	1.57	(1)	(1)

[1] Not available.

SOURCES

Col. 1: 1924–50, "Personal Deductions in the Federal Income Tax," C. Harry Kahn, p. 66; 1956–62, estimated using Kahn's technique of adding 2 percent of estimated AGI of nonfilers and 1.66 percent of AGI on returns with standard deduction.

Col. 2: 1929–35, "National Income," 1954 edition, Department of Commerce, pp. 212–213. 1940–62, "Statistics of Income."

Col. 3: "Statistics of Income."

Col. 4: Includes principally an estimate of endowment income of foundations and of operating charities, i.e., income made available for charitable purposes.

Col. 5: "Annual Report of the National Bureau of Economic Research," 1962, p. 59, interim report of a research project on estimates of private giving by Ralph Nelson.

Col. 6: Ibid., p. 59. Estimates of contributions drawn from recipients have previously been made by various authors. Cf. discussion in Kahn op. cit., pp. 62–4. Nelson's estimates are based upon a more exhaustive coverage of types of recipients, and appear to be more reliable. For overlapping years Nelson's estimates are higher than the previous estimates.

Col. 7: From "Giving U.S.A.," 1963 edition.

Col. 8: This is adjusted gross income as reported on tax returns plus an estimate of unreported AGI including AGI of nonfilers.

The other statistical difficulty involves the accuracy of contributions reported on tax returns. ("Statistics of Income for Individuals" includes unaudited data.) Several authorities in the field have attempted to estimate charitable contributions received by collecting this information from the charities. In some cases estimates have to be reconstructed from estimated expenditures of charitable organizations and changes in endowments. The most reliable of these estimates is a series prepared by Ralph Nelson from which preliminary figures have been published by the National Bureau of Economic Research. Table 2 shows that there has been some relative growth in contributions over time. The ratio of contributions of living individuals based on tax return data shows a growth from the 1920's to recent years from about 1.5 percent of adjusted gross income to about 2.5 percent, roughly an increase of two-thirds. The other series suggest much less growth. The recipient estimate for 1930 is conspicuously high and probably overstates the actual figure. The donor figure is inflated relative to AGI for 1930 because it includes bequests from persons whose deaths occurred (and whose wills were written) in the different atmosphere of the 1920's.

Table 3 presents more detail on estate tax charitable deductions. Here the raw data show little trend because of two offsetting tendencies. By 1959–61, due to growing wealth levels, the United States reached the point where estate tax returns were filed with respect to about 3½ percent of all decedents. The number of returns filed in the 1920's and 1930's covered on the average about 0.9 percent of the decedents. At the same time charitable bequests account for a significantly greater part of the estate for large estates compared to small estates. The broadening of the estate tax coverage brought in relatively more small estates where charitable bequests were less common, thus holding down the contribution ratio.

TABLE 3.—*Charitable bequests reported on estate tax returns*

[Dollar amounts in millions]

Filing year	Gross estate	Charitable bequests					Ratio to gross estate of—	
		Total	Educational, scientific or literary institutions		Religious	Other	Total charitable bequests	Other charitable bequests
			Publicly owned	Privately owned				
							Percent	*Percent*
1961 [1]	$9,362	$850	----------	----------	----------	$683	9.1	7.3
1961	14,622	951	$33	$81	$89	748	6.5	5.1
1959	11,648	669	31	117	86	435	5.7	3.7
1955	7,467	398	(2)	(2)	(2)	(2)	5.3	(2)
1954	7,411	354	(2)	(2)	(2)	(2)	4.8	(2)
1951	5,505	274	(2)	(2)	(2)	(2)	5.0	(2)
1950	4,918	206	17	38	22	129	4.2	2.6
1949	4,933	296	16	98	35	147	6.0	3.0
1948	4,774	223	19	30	25	151	4.7	3.2
1944	2,907	202	18	32	16	135	6.9	4.6
1939	2,746	178	7	44	16	111	6.5	4.0
1934	2,244	146	(2)	(2)	(2)	(2)	6.5	(2)
1929	3,844	154	(2)	(2)	(2)	(2)	4.0	(2)
1924	2,350	66	(2)	(2)	(2)	(2)	2.8	(2)

[1] Top quarter of returns.
[2] Not available.

Source: "Statistics of Income", various years.

The top line of table 3 shows a computation for estate tax returns filed in 1961 where the gross estate was over $200,000. This accounts for about 0.9 percent of all decedents and is thus roughly comparable to the data for the 1920's and 1930's. On this basis the charitable bequests, as a percentage of estates, show an appreciable growth. Robert Lampman's data [2] show that the share of total wealth of the top 1 percent of estate holders declined slightly from the 1920's through 1956.[3] This share is, however, quite sensitive to common stock prices. The fact that common stock prices have risen more than other prices since 1956 would roughly serve to restore the relative share of wealth held by the top 1 percent. On balance it is likely that a larger portion of the property changing hands at death goes into charitable hands via bequests now than was the case in the 1920's. In 1929 the portion might have been 1.5 percent. Presently, it might be 3 percent. The growth is sharper when comparison is made with the early 1920's.

2. Contributions by type of recipient

The data on the types of recipients of charitable contributions are extremely scarce. Table 3 shows a breakdown by broad categories for estate tax deductions for various years. Presumably, the category "other" charitable bequests is made up to a significant extent by bequests to foundations. Kahn, on the basis of very skimpy data, guessed that the bequests to foundations in 1952 may have been in the vicinity of $40 million.[4] A special tabulation of estate tax returns filed in 1957 and 1959 suggests that the annual bequests to "private" organizations might have been about $150 million. The size of "other" bequests has risen from about 60 percent of charitable bequests in 1939 and 1944 to about 80 percent in 1961. All one can say is that this is consistent with a growing tendency to leave property to foundations, but the evidence is not conclusive.

The only tabulation of individual income tax charitable contributions by type of recipient was made for 1962 returns. It is summarized in table 4 which shows the increasing importance of the contribution deduction in the upper brackets, and particularly, the increasing importance of the contributions to "other organizations." This category covers literary, educational, and scientific foundations, libraries, museums, zoos, and other such institutions, including charitable foundations in general.

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[2] Lampman has made the principal analysis of changes in the size distribution of wealth holdings over time. (Robert Lampman, "The Share of Top Wealth Holders in National Wealth," 1922-56, National Bureau of Economic Research, Princeton University Press.)

[3] From about 33 percent to 26 percent, ibid, p. 204.

[4] Kahn, op. cit., p. 225.

TABLE 4.—*Individual income tax deductions for contributions for 1962 by type of recipient and by AGI class*

AGI class	AGI on returns with itemized deductions (billion dollars)	Amount of deductions (million dollars)						Ratio of deductions to AGI, returns with itemized deductions (percent)					
		Total	Religious organizations	Other charitable organizations	Educational institutions	Hospitals	Other organizations	Total	Religious organizations	Other charitable organizations	Educational institutions	Hospitals	Other organizations
Under $5,000	24.9	1,202	850.0	139.0	8.0	5.0	200.0	4.8	3.4	0.6	(1)	(1)	0.8
$5,000 to $10,000	88.4	2,906	2,033.0	402.0	29.0	11.0	432.0	3.3	2.3	.5	(1)	(1)	.5
$10,000 to $20,000	55.6	1,719	1,124.0	264.0	38.0	15.0	277.0	3.1	2.0	.5	0.1	(1)	.5
$20,000 to $50,000	24.1	806	409.0	134.0	56.0	20.0	179.0	3.3	1.7	.6	.2	0.1	.7
$50,000 to $200,000	10.3	509	136.0	84.0	76.0	31.0	182.0	4.9	1.3	.8	.7	.3	1.7
$200,000 to $1,000,000	1.94	200	18.0	22.0	42.0	14.0	103.0	10.3	.9	1.1	2.2	.7	5.3
Over $1,000,000	.66	91	2.6	5.1	16.2	5.2	61.8	13.8	.4	.8	2.5	.8	9.4
Total	206.4	7,516	4,578.0	1,066.0	274.0	113.0	1,485.0	3.6	2.2	.5	.1	.1	.7

Source: Internal Revenue Service, Statistics Division.

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[1] Less than 0.05 percent.

NOTE.—Totals will not add due to rounding.

TABLE 5.—*Estimated total amount of philanthropic contributions by individuals, classified by area of service, 1952 and 1954*

[In millions of dollars]

Area of service	1952	1954
1. Religion	2,281	2,776
2. Education	114	143
3. Health and hospitals	259–303	283–369
4. Social welfare	323	465
5. Private foreign aid	44–91	60–139
6. Foundations	153	160
7. Miscellaneous	122–138	156–187
Total	3,296–3,403	4,043–4,239

Source: C. Harry Kahn, Personal Deductions in the Federal Income Tax, National Bureau of Economic Research, 1960, p. 218.

Table 5, taken directly from C. Harry Kahn, provides an estimate of the breakdown by type of recipient of charitable contribution deductions of living individual donors in 1952 and 1954. These estimates were pieced together by Kahn from material drawn from the charitable organizations. His estimate of contributions to foundations is $160 million, or 3 percent of total contributions.[5] This figure is made up of an estimated $47 million channeled through foundations and $106 million added to foundation capital.[6]

Kahn's estimate of contributions received by foundations in 1952, $40 million from bequests, and $153 million from living donors, also includes an estimated $24 million from corporations. This is Kahn's breakdown of $221 million of contributions to foundations in 1952, a figure estimated by Emerson Andrews (Philanthropic Foundations, p. 17). This total is only one-fourth the size of the $833 million of contributions received by foundations in 1962 based on the Treasury survey in 1964 (cf. discussion infra and table 10). The higher Treasury survey figure is due in part to the broader coverage. This remarkable growth over 10 years, however, is an indication of increasing use of foundations.

This estimate of contributions to foundations in 1962 may be broken down by sources, as follows:

	Millions
Bequests	[1] $175
Corporations	[2] 200
Living individuals	[3] 450

[1] Based on a special tabulation (unpublished) of estate tax returns filed in 1957 and 1959. The figure tabulated from those returns was contributions to organizations that did not appeal to the general public for funds. The figure was scaled up to 1962 levels and rounded. It is a figure particularly subject to erratic year-to-year changes.

[2] This is the Foundation Library Center's estimate of contributions received by "company-sponsored" foundations ("foundations known to have been organized by a business corporation or partnership or to have such an organization as a direct contributor"). Foundation Directory 2, pp. 29–30. The statistic includes some individual contributions, but the definition also has the result of excluding some corporate contributions to noncompany sponsored foundations.

[3] Obtained by subtracting line 1 and 2 from the total contributions received in 1962, as estimated by the Treasury survey.

These components pooled from various sources are extremely rough since the foundation reports themselves do not indicate type of donor. The pattern is roughly consistent with the patterns that Professor Kahn found for 1952, except that this estimate would mark corporations as more important contributors than they appeared to be in the earlier year.

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[5] Kahn's estimate in turn is based mostly on Andrew's Philanthropic Giving, cf. Kahn, op. cit., pp. 224–5

[6] Ibid., p. 225.

Table 6 contains a breakdown of total private giving for 1956 by both sources and uses. This is Ralph Nelson's estimate. Foundation income, as well as the income of endowments of operating charities, is here shown as a source of charitable funds.

TABLE 6.—*The composition of private giving, 1956, donors and recipients, preliminary estimate*

[Dollar values in millions]

Sources (donors)	Amount	Percent	Uses (recipients)	Amount	Percent
Living donors (persons and families)	$7,317	82.3	Religious organizations [1]	$3,569	47.9
Bequests	534	6.0	Private primary and secondary schools	802	10.8
Corporations	418	4.7	Higher education	929	12.5
Foundation endowment income	407	4.6	Secular health	808	10.8
Other endowment income	220	2.5	Secular welfare	1,015	13.6
			Miscellaneous	335	4.5
	8,896	100.0		7,458	100.0

[1] Includes church-supported health and welfare, and excludes parochial schools.

Source: Annual Report of the National Bureau of Economic Research, June 1962, p. 59.

3. The size and growth of foundations

There are no reliable estimates of the growth of the total wealth of charitable organizations including foundations. (Such an estimate would involve, for example, an estimate of the current value of church buildings.) As to the specific subject of this study, private foundations, there are only isolated pieces of information about the accumulated financial holdings; that is, their endowments. One piece is provided by the periodic surveys of share ownership of listed stocks, undertaken by the New York Stock Exchange. Another is provided by studies of total assets of foundations.

It is, of course, rather meaningless to point out that foundations and endowments have been growing. The more important point is how this growth compares with that of the total economy; that is, has the position of foundations grown relative to other charitable organizations, or relative to the total private wealth?

The total asset data on foundations are the result of periodic surveys undertaken by private researchers. The early foundation surveys were based upon information that the surveyors could glean from newspaper reports, correspondence, guessing at the importance of small foundations, and the like. This kind of approach is quite likely to include the large well-known organizations, but it becomes very spotty as an estimate of the small ones. Since 1950, these data have been strengthened by the availability of annual information returns under the Internal Revenue Code from many foundations.

Table 7 contains some information on the available survey-type information on total asset holdings of foundations. For comparison these are shown along with an estimate of endowments of institutions of higher education and of the total value of assets of individuals, including nonprofit institutions.

The figures in table 7 indicate considerable growth of foundations relative to the aggregate individual total wealth. The size of foundations since 1930 would seem to be increasing 17 times while the aggregate individual wealth was increasing 4 times. The faster growth of foundations appears to persist throughout the period. The real question is how reliable the early figures are. Two conspicuous defects are coverage and valuation methods.

Coverage.—The Treasury's 1964 survey indicated that in the aggregate the small foundations do not make much contribution to the size of total foundation assets. The 1930 study, for example, grossly underestimates the number of foundations, giving a figure of 122. The 1964 Foundation Directory, however, lists 165 foundations which had assets over $1 million in 1962 and were organized before 1930. The procedure followed in 1930, presumably, should have identified and included the large well-known foundations. If the excluded ones were equivalent to the aggregate of the medium and small groups in the 1964 figures, it would be reasonable to raise the $950 million estimate to $1,100 million; that is, by 15 percent, to cover the additional foundations.

Valuation.—The 1930 study requested only ledger values of assets. The 1931 study requested market values as well, but only eight foundations gave both ledger and market values. For these eight, the aggregate market value was about 12 percent below ledger value. Market values of stocks in 1931, however, were only two-thirds of values in 1930. Assuming that most of the assets were in stocks, it is a guess that the market value of all foundations (i.e., including the above adjustment for the small foundations) was about $1,300 million.

These adjustments have been very rough. It would be better to conclude that the value of foundation assets in 1930 was $1–$2 billion. Even if we take the top of this range, foundation assets in the aggregate have multiplied eight times in value since 1930 while total wealth has increased four times. From the lower end of this range the increase was 16 times for foundations.

Table 7 would indicate that since 1930 foundations have increased their share of the total wealth of individuals from 0.25 percent to about 0.8 percent. If we use the previously derived estimate of $1.3 billion as the market value of foundation wealth in 1930, the share of foundations was then 0.33 percent. Higher education endowments increased roughly in proportion to total individual wealth.

Table 8 shows some information on the holdings of stock registered on the New York Stock Exchange (NYSE). In the aggregate the portion of total stocks registered on the NYSE owned by foundations is 2.6 percent.[7] The figure would seem to be high in relation to the indication of table 7 that foundations own slightly under 1 percent of the total wealth of individuals. The principal explanation is that foundations hold over twice as high a proportion of their wealth (about two-thirds) in the form of common stock than is the case for all individuals (about one-third). Further, foundations have a higher proportion of their stockholdings in the form of stocks listed on the NYSE (after the inclusion of Ford stock) than is true of individuals generally.[8]

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[7] The Ford Motor Co. stock held by the Ford Foundation is a special class of nonvoting common which is not listed on the NYSE. When the Ford Foundation sells any stock, the shares to be sold are exchanged for the listed common stock and delivered. Since the concern of the immediate inquiry is the wealth of foundations, rather than voting power, it is useful to add the Ford Foundation holdings of Ford stock to the listed holdings. Both figures are shown in table 8. The Ford figures were obtained from the Ford Foundation.

[8] An SEC study indicated that in a sample of foundations, covering 56 percent of foundation holdings, 87 percent of foundation stock investments was in shares listed on the NYSE. "Report of Special Study of Securities Markets," pt. II, p. 838.

Two striking indications from the stockholding data should be noted: (1) There has been no significant growth in the stockownership of foundations relative to the total market since 1949; and (2) there has been a small decline in the share of college and university endowments. The total share of all tax-exempt organizations (other than pension funds) was almost unchanged but down slightly.

TABLE 7.—*Data on total assets of foundations and higher education endowments*

[Dollar amounts in billions]

Year	Number (1)	Assets of foundations (2)	Endowments of colleges and universities [1] (3)	Total assets of individuals (4)
1930	122	$0.95	$1.3	$380
1944	505	1.82		600
1950	1,007	2.57	2.4	921
1954	4,164	4.52		1,200
1959	5,202	11.52	5.0	1,670
1962	6,007	14.51	6.4	1,930
1962 [2]	15,000	16.26	6.4	1,930

[1] This refers only to the endowment in investment assets. Physical plant of colleges and universities also serves as endowments, yielding services rather than cash. If these were included, higher education endowments would exceed those of foundations.

[2] 1964 Treasury Department Survey of Private Foundations.

SOURCES

Cols. (1) and (2):

1930: "American Foundations and Their Fields," Twentieth Century Fund. The tabulation contained in this report lists foundations with assets of $853,000,000, but 17 of the 122 foundations did not submit asset figures. The report contains the estimate that for all 122 foundations an asset figure of $950,000,000 "is probably not wide of the mark."

1944: "American Foundations for Social Welfare," Harrison and Andrews, Russell Sage Foundation, 1946, p. 58.

1950: "Philanthropic Giving," Andrews, Russell Sage Foundation, 1953, p. 93.

1954: "American Foundations and Their Fields," 7th ed.

1959: "Foundation Directory 1," Russell Sage Foundation, 1960.

1962: "Foundation Directory 2," Russell Sage Foundation, 1964.

Col. (3):

1930–59: Office of Education.

1962: "Giving U.S.A.," 1963 ed., p. 14, American Association of Fund Raising Counsel.

Col. (4):

1930–54: "Studies in National Balance Sheet of United States," Goldsmith, vol. II, pp. 124–125. The 1930 figures were interpolated between Goldsmith's estimates for 1929 and 1932 on the basis of aggregate value of corporate shares.

1959–62: "Flow of Funds Accounts," FRB. Total assets were estimated using observed trend of ratio of total to intangible in Goldsmith's data.

TABLE 8.—*Estimated holdings of New York Stock Exchange listed stocks by certain exempt institutions*

[Dollar amounts in billions]

DOLLAR HOLDINGS

	1949	1956	1960	1961	1962	1963
Foundations:						
Listed stocks	$1.1	$4.1	$5.3	$7.2	$6.7	$8.0
Ford stock held by Ford Foundation	.9	2.1	2.3	3.1	2.1	2.7
Total	2.0	6.2	7.6	10.3	8.8	10.7
College and university endowments	1.1	2.4	2.9	3.7	3.3	4.0
Other nonprofit organizations	1.0	3.1	4.4	5.6	5.0	5.9
Noninsured pension funds	.5	5.8	(1)	18.9	18.2	23.4
Market value of all listed stocks [2]	77.2	221.3	309.3	390.1	347.9	414.0

PERCENTAGES [2]

	1949	1956	1960	1961	1962	1963
Foundations (including Ford stock)	2.6	2.8	2.5	2.6	2.5	2.6
College and university endowments	1.4	1.1	.9	.9	.9	1.0
Other nonprofit organizations	1.3	1.4	1.4	1.4	1.5	1.4
Total nonprofit organizations	5.3	5.3	4.8	5.0	4.9	5.0
Noninsured pension funds	.7	2.6	(1)	4.8	5.2	5.7

[1] Comparable figure not available.
[2] Includes Ford stock held by Ford Foundation.

Source: "NYSE Fact Book," 1963 and 1964. Ford figures obtained from Ford Foundation. The 1949 figure was obtained using the book equity of the Ford Motor Co.

The two sets of data in tables 7 and 8 seem to suggest two different conclusions about the relative growth of foundations. The total estimates in table 7 suggest a growth in the relative share continuing through the 1950's. The stockholding data in table 8, however, suggest a cessation in the growth in the relative share of foundations after 1950.

The quality of the data available does not admit of any precise reconciliation of these two sets of statistics. The early survey was admittedly incomplete as to coverage of foundations, and this coverage gradually improved. Also, the later surveys reflected a mixture of market values and ledger values. The stockholding data are based on a limited sample.

A large part of the discrepancy is accounted for by the fact that foundations have a very large portion of their investment in common stock compared to individuals and even compared to higher education endowments. Common stock has advanced far more in price in the last 15 years than other assets. This has been caused by both the growth in dividends and an increase in the price-earnings ratio. The implications of the stockholding data are that stock investments of foundations were not growing faster than the stock investments of other stock investors. All stock investors were gaining compared to people who owned just bonds, bank accounts, and insurance. Since foundations are heavily invested in stocks, this resulted in better than average growth for foundations, compared to total individual wealth.

If foundations were growing faster than other investors due to either an increasing flow of contributions or due to a parsimonious policy of distribution to charity, this should show up in the NYSE data as growth relative to other stock investors. It is significant that there is so little growth of this sort in the NYSE data.

Another evidence of foundation growth is afforded by recording the organization dates of presently large foundations. This serves to identify the 1940's and 1950's as the period of rapid foundation growth, although it is striking that the foundations established since 1950 are relatively small compared to those established before 1950. These data are contained in table 9.

On the basis of the meager evidence available, the following conclusions are suggested about private foundation growth:

(*a*) There was some growth of foundations relative to the rest of the economy in the 1930's and 1940's. This can be associated with the adoption of increased progressivity in estate and income taxes in the early 1930's plus the charitable contribution deduction under each tax.

(*b*) Since 1950, the total wealth of foundations has grown faster than the rest of the economy, but in this period the faster growth was probably due to the fact that their principal assets and corporate stocks were increasing in price faster than other assets. In terms of values of shares owned, the proportion owned by foundations appears to have been quite stable.

TABLE 9.—*Period of establishment of 5,050 foundations, by decades after 1900: by latest asset classes* [1]

Period	Number	Percent	Latest asset classes					
			$10 million or more		$1 million under $10 million		Less than $1 million	
			Number	Percent	Number	Percent	Number	Percent
Total	5,050	100	175	100	800	100	4,075	100
Before 1900	18	(2)	1	1	9	1	8	(2)
1900 to 1909	18	(2)	8	5	5	1	5	(2)
1910 to 1919	76	2	14	8	36	4	26	1
1920 to 1929	173	3	27	15	65	8	81	2
1930 to 1939	288	6	45	26	100	12	143	3
1940 to 1949	1,638	32	54	31	299	38	1,285	32
1950 to 1959 [3]	2,839	56	26	15	286	36	2,527	62

[1] The 5,050 foundations tabulated here are those that had at least $100,000 of assets in 1962 and were thus included in the "Foundation Directory" and which also provided information to the Foundation Library Center as to date of organization.

[2] Less than 0.5 percent.

[3] Record incomplete; the fragmentary 1960—record (45 foundations) not included in table.

Source: "Foundation Directory," ed. 2, p. 13.

4. 1964 survey of foundations

In 1964 the Treasury Department conducted a survey of certain financial aspects of private foundations.[9] The survey involved initially selecting a sample of approximately 1,300 organizations whose Form 990–A was available (principally at the Foundation Library Center office in Washington, D.C.).

Certain parts of the information return, Form 990–A, are required by law to be made available to the public. The Foundation Library Center, a private, nonprofit organization, maintains a file of copies of this public part of the tax return for those exempt organizations which meet their definition of a foundation. The "Foundation Directory," edition 2, page 9, published in 1964, explains the definition of a foundation used by the Center as follows:

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[9] In the conduct of this survey assistance was obtained from the Internal Revenue Service and the Foundation Library Center offices in Washington, D.C., and New York City.

> For purposes of this directory a foundation may be defined as a nongovernmental, nonprofit organization having a principal fund of its own, managed by its own trustees or directors, and established to maintain or aid social, educational, charitable, religious, or other activities serving the common welfare. Both charitable trusts and corporations are included. As previously, the new directory excludes "foundations" which make a general appeal to the public for funds; which act as trade associations for industrial or other special groups; which are restricted by charter solely to aiding one or several named institutions; or which function as endowments set up for special purposes within colleges, churches, or other organizations and are governed by the trustees of the parent institution. Obviously, many "foundations" fall in a gray area, with most of the characteristics of regular foundations but some disqualifications; edition 2 interprets the exclusions more rigidly than did its predecessor.

The "Foundation Directory" published by the Foundation Library Center omits "very small" foundations. The files of the Foundation Library Center do, however, contain copies of the Form 990–A for many of these very small foundations.

Since the word "foundation" is not technically defined for tax purposes, there is no ready way to separate those organizations called foundations from other tax-exempt organizations so far as tax information returns are concerned. As a means of obtaining a body of statistical information, it seemed necessary to utilize the classification which had been established by the Foundation Library Center. Data have been added for certain very large organizations which one might want to define as a foundation where these could be identified.[10] No effort was made to expand the center's definition in the other size categories. The Foundation Library Center indicates that their records show that there were approximately 15,000 foundations, according to their definition, in existence around the end of 1962. Of these, an estimated 9,000 were below $100,000 in total assets.

A stratified sampling design was adopted that would produce a sample of about 1,300 foundations. It developed that the 1962 Form 990–A was available in the Foundation Library Center for only about one-half of the total number of foundations. This was principally due to delays involved in obtaining and reproducing the returns. The sampling rates for the foundations below $1 million in size were accordingly doubled, and in the group of foundations with assets size of over $10 million other sources were utilized to obtain the Forms 990–A for the year 1962 in order to carry out the plan to have 100 percent coverage in this area. Information was taken from the Form 990–A, and a supplementary questionnaire was sent to each of the foundations whose return was selected.[11] In the aggregate a response rate of close to 98 percent was realized.[12]

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[10] Since the particular concern of the present study was private foundations, several community foundations which could be readily identified were omitted from the tabulation.

[11] Copies of the Form 990–A (including instructions) and the supplemental questionnaire are attached as exhibits 1 and 2, respectively.

[12] When the initial machine tabulation of results was run, the response rate to the questionnaire was about 96 percent. Those organizations from which a questionnaire was not received were tabulated in a special category called unclassified. The results of the initial run were adjusted in the very large category so as to shift several foundations from unclassified to the appropriate donor influence category on the basis of the questionnaire when it was received. Further, for several tabulations of market value asset data, the 2 percent of questionnaires received after the initial tabulations were taken into account. In the remaining cases where negligible effects would be involved, these last 2 percent of questionnaires received were not reallocated from the unclassified category tabulated. The total market value of assets of the unclassified category was calculated, where necessary, by raising the ledger values on stockholdings on the basis of market to ledger ratios for stockholdings on those foundations reporting market values.

The discussion in the following sections is based upon a tabulation of the return forms and questionnaire results. The statistics collected in the sample have been blown up to provide an estimate of the data for all 15,000 foundations. In the tables the small foundations are those whose assets at the beginning of 1962 were under $100,000. The medium foundations had assets of $100,000 to $1 million. The large foundations had assets of $1 million to $10 million. The very large foundations had assets over $10 million.

5. *The income of foundations*

In 1962 foundations in the aggregate had $1,065 million of total income after investment expenses, but including capital gains. Some material on the aggregate income of foundations is given in table 10.

TABLE 10.—*Aggregate income of foundations*

[Dollar amounts in millions]

	Total	Asset size				Percent of donor-related influence over investment policy				
		Very large over $10,000,000	Large, $1,000,000 to $10,000,000	Medium, $100,000 to $1,000,000	Small under $100,000	50 percent or more	Over 33 percent but not over 50 percent	Over 20 percent but not over 33 percent	Not over 20 percent	Unclassified
Number of foundations	14,865	175	800	4,910	8,980	11,000	810	100	2,430	526
RECEIPTS										
1. Gross profit from business activities [1]	$8	$3	$3	$1	$1.7	$1	$1	$1	$6	(2)
2. Interest	159	104	35	18	2.1	47	12	8	91	$1
3. Dividends	374	268	67	36	3.1	125	28	18	197	6
4. Rents	43	21	16	5	.7	16	1	9	14	(2)
5. Other ordinary income	57	39	5	12	1.2	30	5	3	20	1
6. Less expenses of earning gross income	62	35	13	11	2.6	28	5	8	20	1
7. Net ordinary income	580	400	113	61	6.2	194	42	31	307	6
8. Gains from sale of assets, excluding inventory	484	434	33	15	1.0	45	14	3	419	2
9. Total net ordinary income plus gains	1,065	834	146	76	7.2	239	56	34	726	10
10. Contributions received (net)	833	290	251	235	57.4	536	30	18	238	13
11. Total receipts (ordinary income, capital gains and contributions received)	1,898	1,124	397	311	64.6	775	86	52	964	23
GRANTS FROM INCOME										
12. Net	693	478	139	68	8.1	233	40	30	381	8
13. Cost of distribution	64	36	16	11	.8	20	4	2	38	1
14. Gross	757	514	155	79	8.9	253	44	32	418	9
GRANTS FROM PRINCIPAL										
15. Net	239	32	68	111	28.1	174	11	6	41	8
16. Cost of distribution	16	1	5	7	2.5	4	2	3	5	5
17. Gross	255	33	73	118	30.6	178	12	8	46	13
18. Total grants	1,012	547	228	197	39.5	431	56	40	464	21

[1] Gross sales or receipts from related and unrelated business activities less cost of goods sold or of operations.

[2] Less than $500,000.

Details may not add to totals due to rounding.

Source: 1964 Treasury Department Survey of Private Foundations.

Some summary figures on income and outgo of all foundations are given below. The total is shown with and without the Ford Foundation.

[Dollar amounts in millions]

	Total, including the Ford Foundation	Total, excluding the Ford Foundation
Net ordinary income	$580	$444
Capital gain	$484	$157
Total income	$1,065	$601
Grants out of current and accumulated income [1]	$757	$534
Contributions received	$833	$833
Grants out of principal [1]	$255	$255
Net worth (ledger values)	$10,856	$8,480
Rate of return (ordinary income) on ledger values (average beginning and end of year) (percent)	5.6	5.4
Net worth (market values)	$15,470	$12,430
Rate of return on market values (excluding capital gain) (percent)	3.7	3.6
Rate of grants to market net worth (end of year) (percent)	6.5	6.3

[1] Includes direct expenditure on charitable purposes and costs of making grants.

The total income of all foundations in 1962 was greatly affected by the large capital gains realized by the Ford Foundation.

If the Ford Foundation had realized capital gains only in the same relationship to total assets as all the other foundations, the aggregate income of foundations would have been reduced by almost $300 million to about $780 million.

In the aggregate Foundations made grants of $693 million which were reported as coming out of income. These grants involved a distribution cost of $64 million, and consequently, $757 million was spent in making distributions to charitable beneficiaries from current and accumulated income, about $320 million less than the current income including capital gains. (About $230 million of this excess of current income including capital gains over distributions came from the Ford Foundation, where there were relatively larger capital gains as defined above of about $300 million.)

During 1962, foundations received additional gifts of $833 million. In addition, the returns indicate that $239 million of grants were made to charitable beneficiaries from principal. These grants involved a distribution cost of $16 million, and thus, $255 million was spent making distributions from principal. In the aggregate, all grants including distribution costs exceeded current ordinary income by about $430 million.

The following is offered as a way of getting these aggregate statistics into some general perspective; other perspectives are possible. In 1962, if capital appreciation is temporarily left aside, foundations earned ordinary income of $580 million. At the same time the total outlay on grants, including distribution costs, was about $1,100 million, or about $520 million more than the total ordinary income. At the same time, foundations received contributions from outsiders of $833 million. Out of current ordinary income and contributions (i.e., excluding capital appreciation and realization of capital gains) about $300 million was set aside for growth of the foundations. This amounted to just about 2 percent of the net worth at the beginning of 1962.

In addition to this current income, foundations were able to enjoy some appreciation of their wealth holdings. To take a longrun view of this, the matter of how much of this appreciation occurred or was realized in 1962 may be put aside in order to concentrate on the expected value of the appreciation itself. About two-thirds of the current market value of the assets of foundations was represented by investment in corporate stock. Over the long run, it is not unrealistic to expect corporate stock to appreciate in value at a rate of about 5 percent a year.[13] With about two-thirds of the assets invested in common stock, the annual appreciation on total assets in the long run ought to be about two-thirds of 5 percent or about 3 percent a year. This when combined with the previously calculated 2 percent of net worth addition from current operations and contributions would indicate a rate of growth for the existing foundations of about 5 percent a year. This is itself in line with the common expectation of the growth in the gross national product, and if all foundations taken together grew at this rate, they would simply maintain their present relative importance compared to other wealthholders. They would neither get comparatively larger nor smaller. Foundations with their heavy investment in common stock would still gain if stock prices advance relative to other prices, or would lose ground if stock prices fall.

As was seen in the prior analysis of the New York Stock Exchange data, foundations do not appear to have changed their relative share of stockholdings since 1950. It was also argued that much of the growth of foundations' share of total wealth relative to the rest of the society could be explained by the abnormal capital appreciation in their major investment, stocks, since World War II. The foregoing analysis of the 1962 income account does not purport by itself to show that foundations will not expand relative to the rest of the economy. It indicates that in a general way the 1962 income account seems to be consistent with the New York Stock Exchange data suggesting no significant growth of foundations in the aggregate relative to the rest of the economy. With the kind of investment portfolio foundations have, normal capital appreciation will be about 3 percent a year. Foundations in the aggregate, by retaining in 1962 out of new contributions and income (other than capital gains) about 2 percent of their net worth, grew at a rate equivalent to the rest of the society.[14]

It should be quickly added that much of the annual contribution is for newly established foundations. If foundations, taken in the aggregate, are not to grow at a faster rate than the rest of the society while new foundations are being formed, then existing foundations will have to grow at well under 5 percent a year.

Also, it should be added that it is not here proposed that foundations in the aggregate should grow at exactly the same rate as the private sector. This analysis only goes to throwing some light on the rate of growth that does exist.

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[13] This is consistent with the aggregate value of corporations increasing in proportion to the aggregate profit of corporations, which ought to increase in proportion to the gross national product, which is commonly expected to increase at about 5 percent a year.

[14] Clearly, many foundations accumulated more of this out of ordinary income and contributions. If we examine all foundations except Ford, the accumulation out of ordinary income plus contributions was 4 percent of market value.

As will be seen from table 10, about two-thirds of the ordinary income of foundations came from dividends. The bulk of the remainder came from interest. Only 10 percent came from rents, and only 1 percent from the direct conduct of business activities. The relative shares of different sources were about the same for various size foundations with the exception of the small foundations where the dividend portion of the ordinary income was only about one-half, and the profit from direct business activity was about one-quarter. It should be observed in table 10 that the data with respect to small foundations are given in tenths of millions of dollars compared to the other statistics which are given in round millions of dollars. An additional decimal point is carried for the small foundation data only to give a better perspective of the relative size of various entries.

6. The wealth of foundations

Table 11 summarizes some balance sheet and related wealth information for foundations on the basis of the 1964 Treasury survey. In terms of the values which foundations carry on their books, generally the value when contributed or cost if acquired later, but sometimes market, the total assets of foundations were $11.6 billion, and the net worth was $10.9 billion at the end of the 1962 reporting year. In terms of the foundations' estimates of market values of their assets, the total assets were $16.3 billion and net worth was $15.5 billion. About two-thirds of this wealth was owned by the largest 175 foundations each of which exceeded in size $10 million measured by total assets at book (or ledger) value. The small foundations, those with assets under $100,000, comprising about 60 percent of all foundations, held slightly less than 2 percent of the assets of all foundations.

TABLE 11.—*Assets of foundations, beginning of tax year 1962*

[Dollar amounts in millions]

	Total	Asset size				Percent of donor-related influence over investment policy				
		Very large, over $10,000,000	Large, $1,000,000 to $10,000,000	Medium, $100,000 to $1,000,000	Small, under $100,000	50 percent or more	Over 33 percent, not over 50 percent	Over 20 percent, not over 33 percent	Not over 20 percent	Unclassified
Number of foundations	14,865	175	800	4,910	8,980	11,000	810	100	2,430	525
	LEDGER VALUES, END OF THE YEAR									
ASSETS										
1. Cash	$443	$110	$124	$166	$43	$268	$31	$21	$109	$14
2. Accounts receivable	50	12	9	25	4	82	1	(1)	14	4
3. Notes receivable	189	118	30	35	6	117	32	18	21	(1)
4. Mortgage loans	149	63	61	19	6	60	13	(1)	77	1
5. Corporation stock	6,529	4,409	1,237	783	100	2,620	488	249	3,072	103
6. Other assets [2]	5,119	3,174	1,095	744	106	1,728	351	266	2,737	35
7. Total assets	11,648	7,583	2,332	1,527	206	4,348	839	515	5,809	138
LIABILITIES										
8. Accounts payable	17	8	6	3	(1)	5	1	1	7	1
9. Grants payable	524	488	31	5	(1)	75	10	20	419	(1)
10. Bonds, etc., payable	137	73	32	27	5	101	4	11	22	(1)
11. Other liabilities	114	53	42	15	4	44	3	2	64	1
12. Net worth (L)	10,856	6,961	2,221	1,477	197	4,120	821	481	5,297	136
	MARKET VALUES, END OF THE YEAR									
13. Corporation stock (M)	10,896	8,050	1,783	955	108	3,880	860	668	5,331	159
14. Total assets (M)	16,262	11,331	2,940	1,773	218	5,666	1,270	945	8,180	201
15. Net worth (M)	15,470	10,709	2,829	1,723	209	5,438	1,252	911	7,668	199

[1] Less than $0.5 million.

[2] This is almost all bonds.

Source: 1964 Treasury Department Survey of Private Foundations.

In slightly over two-thirds of all foundations by number, the donor or persons related in some way to the donor made up 50 percent of those trustees who take some voice in investment policy, including the decision of how much of the currently available funds will be reinvested and how much will be applied to charitable purposes. (A trustee whose sole participation involves selecting which charitable activity gets the money was not taken into account.) Foundations were classified by the portion of trustees who participated in investment policy, as defined above, who were related in any way to the donor, including his lawyers, his accountant, distant relatives, and employees. The number in each classification would be affected very little if a narrower definition of donor-related trustee were utilized, since in most cases the influence was exercised through immediate family members on the board. In dollar terms the foundations with less than 20 percent influence were slightly more important than the foundations with 50 percent or more donor influence because of the presence of some very large foundations, such as Ford in the former category.

Foundations have extremely little indebtedness. Excluding grants payable, the total liabilities of foundations amount to barely more than 2 percent of ledger assets.

7. *Certain ratios with respect to foundations*

Table 12 classifies the foundations by certain ratios involving grants, income, and assets. The table gives estimated figures for all foundations, that is, the sample portion of the survey was blown up. The first four banks of the table show the ratio of grants to various sources of income. The next four banks deal with various ratios of income to net worth. The last two show ratios of grants made to net worth. In the aggregate the average ratio of ordinary income (net) to book value was 5.6 percent and to market value 3.7 percent. The average rates of total income (ordinary income plus capital gains) to book and market values, respectively, were 10.6 percent and 6.8 percent. Grants were on the average 172 percent of ordinary income and 94 percent of total income. They were equal to 120 percent of contributions received and 53 percent of total sources (total income plus contributions received). On the average, grants were 10 percent of book net worth and 6.4 percent of market net worth.

TABLE 12.—*Distribution of number of foundations by various ratios*

	All foundations	Percent of donor-related influence over investment policy					Asset size			
		50 percent or more	Over 33 percent, not over 50 percent	Over 20 percent, not over 33 percent	Not over 20 percent	Unclassified	Very large, over $10,000,000	Large, $1,000,000 to $10,000,000	Medium, $100,000 to $1,000,000	Small, under $100,000
Total[1]	14, 850	10, 990	810	100	2, 420	530	164	800	4, 910	8, 980
	Ratio of grants (gross) to total income (ordinary income plus capital gains)									
Below 25 percent	880	410	50	10	380	30	5	30	230	620
25 to 50 percent	430	240	30	0	160	1	14	60	220	140
50 to 100 percent	2, 070	1, 290	180	20	520	60	74	200	960	780
100 to 150 percent	1, 680	1, 140	120	20	360	50	51	170	840	620
Over 150 percent	5, 810	4, 680	200	50	670	220	19	260	3, 170	3, 360
No computation (total income zero or negative)	3, 980	3, 241	230	10	320	170	1	40	490	3, 400
	Ratio of grants (gross) to ordinary income									
Below 25 percent	700	310	40	10	320	20	3	20	140	540
25 to 50 percent	260	130	30	0	100	10	3	20	160	80
50 to 100 percent	1, 990	1, 220	180	10	520	40	62	240	920	760
100 to 150 percent	1, 720	1, 110	120	20	410	60	63	190	870	600
Over 150 percent	6, 690	5, 440	210	50	740	250	33	320	2, 500	3, 840
No computation (ordinary income zero, or negative)	3, 500	2, 780	230	10	330	150	0	20	320	3, 160
	Ratio of grants (gross) to total sources (total income plus contributions received)									
Below 25 percent	2, 920	2, 020	160	20	640	80	16	160	950	1, 800
25 to 50 percent	2, 260	1, 750	110	0	340	60	19	110	970	1, 160
50 to 100 percent	4, 100	3, 010	200	60	700	140	85	340	1, 440	2, 240
100 to 150 percent	2, 010	1, 430	150	20	340	70	33	140	610	1, 220
Over 150 percent	2, 350	1, 820	130	10	260	120	10	90	770	1, 480
No computation (total sources zero or negative)	1, 220	960	60	0	130	60	1	20	170	1, 020

See footnotes at end of table, p. 87.

TABLE 12.—*Distribution of number of foundations by various ratios*—Continued

	All foundations	Percent of donor-related influence over investment policy					Asset size			
		50 percent or more	Over 33 percent, not over 50 percent	Over 20 percent, not over 33 percent	Not over 20 percent	Unclassified	Very large, over $10,000,000	Large, $1,000,000 to $10,000,000	Medium, $100,000 to $1,000,000	Small, under $100,000
Total [1]	14,850	10,990	810	100	2,420	530	164	800	4,910	8,980
	Ratio of grants to contributionsreceived									
Below 25 percent	2,010	1,530	60	10	360	50	6	60	620	1,320
25 percent to 50 percent	1,770	1,370	130	1	240	40	7	60	680	1,020
50 percent to 100 percent	2,620	2,220	80	20	230	70	7	70	850	1,700
100 percent to 150 percent	1,550	1,240	100	4	150	50	8	80	840	1,020
Over 150 percent	2,060	1,460	100	20	390	80	58	250	730	1,020
No computation (no contributions received)	4,850	3,180	330	40	1,060	230	78	280	1,590	2,900
	Ratio of total income to book net worth									
Total income negative	990	800	70	10	50	50	1	20	370	600
0 to 1 percent	3,600	2,910	160	10	360	140	7	30	400	3,160
1 to 3 percent	2,830	2,095	150	10	470	110	11	100	1,060	1,660
3 to 6 percent	4,730	3,350	260	50	950	110	63	360	2,040	2,260
6 to 10 percent	1,260	890	90	20	260	10	55	180	520	500
Over 10 percent	1,150	730	60	10	270	90	26	100	460	560
No computation (no book net worth)	310	190	20	0	80	20	1	10	60	240
	Ratio of total income to market net worth									
Total income negative	990	800	70	10	50	50	1	20	370	600
0 to 1 percent	3,640	2,920	190	10	370	140	7	40	390	3,200
1 to 3 percent	3,270	2,440	160	20	530	110	28	140	1,280	1,820
3 to 6 percent	4,620	3,240	270	50	950	120	89	420	1,900	2,120
6 to 10 percent	930	690	50	3	180	3	27	100	390	420
Over 10 percent	1,150	720	50	4	300	80	11	70	450	620
No computation (no market net worth)	260	170	20	0	50	20	1	20	40	200

Total [1]	14,850	10,900	810	100	2,420	530	164	800	4,910	8,980
	Ratio of ordinary income to book net worth									
Ordinary income negative	440	260	50	10	60	30	0	10	220	180
0 to 1 percent	3,840	3,160	170	10	370	130	9	20	430	3,380
1 to 3 percent	3,600	2,720	160	50	550	160	15	140	1,330	2,120
3 to 6 percent	5,280	3,720	310	15	1,070	140	87	460	2,330	2,400
6 to 10 percent	840	550	80	5	170	30	40	110	310	380
Over 10 percent	570	400	20	10	120	20	12	50	230	290
No computation (no book net worth)	310	190	20	0	80	20	1	10	60	240
	Ratio of ordinary income to market net worth									
Ordinary income negative	440	260	50	10	60	30	0	10	220	180
0 to 1 percent	3,880	3,150	200	20	390	130	10	30	420	3,420
1 to 3 percent	4,140	3,120	190	50	640	160	44	220	1,540	2,340
3 to 6 percent	4,990	3,500	280	2	1,020	140	90	460	2,260	2,180
6 to 10 percent	570	390	50	4	100	30	16	40	210	300
Over 10 percent	620	420	10	10	160	20	3	30	220	360
No computation (no market net worth)	260	170	20	0	50	20	1	20	40	200
	Ratio of grants to book net worth									
0 to 1 percent	1,370	730	120	20	450	50	9	20	280	1,060
1 to 3 percent	1,470	1,000	110	20	280	60	14	90	630	740
3 to 6 percent	2,810	1,890	190	10	670	60	66	280	1,420	1,040
6 to 10 percent	1,820	1,410	80	10	250	70	44	170	860	740
Over 10 percent	7,070	5,780	300	40	680	270	30	220	1,660	5,160
No computation (no book net worth)	310	190	20	0	80	20	1	12	60	240
	Ratio of grants to market net worth									
0 to 1 percent	1,440	730	120	20	510	50	9	30	280	1,120
1 to 3 percent	1,820	1,200	160	20	380	60	39	160	810	280
3 to 6 percent	2,750	1,850	190	10	630	60	76	280	1,350	1,040
6 to 10 percent	1,710	1,380	40	2	220	60	28	140	810	740
Over 10 percent	6,880	5,660	270	40	670	280	11	190	1,620	5,060
No computation (no market net worth)	260	170	20	0	50	20	1	20	40	200

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[1] Differs slightly from number in Tables 10 and 11 because this table excludes about 10 large foundations for which data were not available when this table was prepared.

Source: 1964 Treasury Department Survey of Private Foundations.

8. *Frequency of certain transactions*

Table 13 summarizes the answers to a number of questions asked on the Form 990–A concerning the occurrence of various transactions between the foundation and a substantial donor, and various persons related to the donor.

Under present law, the transactions involved in question 2 might be considered prohibited transactions, a cause for denial of the charitable exemption, only if the price involved in the transaction was not an arm's-length price. The question is designed to call the attention of a revenue agent to a particular transaction that might need to be investigated further. A foundation answering "yes" to any part of this question does not indict itself as having forfeited its exemption, but it is possible that some of these transactions go unreported in order to avoid having questions raised by revenue agents. Because of this possibility the answers to question 2 on table 13 may understate the frequency of these transactions.

The answers to question 3 on table 13 are in response to a question on the supplemental questionnaire, relating to the occurrence of transactions between the foundation and its officials (and parties related to such officials). Present law does not contain a specific prohibition on these types of transactions. Occurrence of one of the listed transactions between a foundation and an official, or a party related to an official of the foundation would be indicated by a "yes" answer to that part of question 3.

Question 4 dealing with holdings of 10 percent or more of any class of stock was also taken from the supplemental questionnaire.

TABLE 13.—*Responses to questions concerning certain transactions, etc.*

1. Did you hold any real property for rental purposes with respect to which there is an indebtedness incurred in acquiring the property or in making improvements thereto or which was acquired subject to a mortgage or similar lien?

[In percent]

	Yes	No	No answer
Total	1.2	97.1	0.7
Very large	3.7	92.1	4.3
Large	3.5	95.5	1.0
Medium	2.6	96.4	1.0
Small	.2	99.4	.4
Donor influence 50 percent or over	1.1	94.6	4.3
Donor influence under 50 percent, over 20 percent	.4	98.3	1.2
Donor influence not over 20 percent	2.1	96.0	1.9
Unclassified	2.3	97.7	0

2. After July 1, 1950, did—

The creator of your organization, or

A contributor to your organization, or

A brother or sister (whole or half blood), spouse, ancestor, or lineal descendant of such creator or contributor, or

A corporation owned (50 percent or more of voting stock or 50 percent or more of value of all stock) directly or indirectly by such creator or contributor

(*a*) Borrow any part of your income or corpus?

[In percent]

	Yes	No	No answer
Total	0.9	98.2	0.9
Very large	1.2	94.4	4.3
Large	1.5	96.0	2.5
Medium	1.6	97.2	1.2
Small	.4	99.2	.4
Donor influence 50 percent or over	1.3	98.1	.6
Donor influence under 50 percent, over 20 percent	.1	98.7	1.2
Donor influence not over 20 percent	.8	97.0	2.1
Unclassified	0	100.0	0

(*b*) Receive any compensation for personal services from you?

[In percent]

	Yes	No	No answer
Total	1.4	97.7	1.0
Very large	5.5	90.3	4.3
Large	4.0	94.0	2.0
Medium	2.4	96.4	1.2
Small	.4	99.0	.6
Donor influence 50 percent or over	1.4	98.0	.7
Donor influence under 50 percent, over 20 percent	3.8	94.9	1.2
Donor influence not over 20 percent	.7	97.2	2.1
Unclassified	.2	99.8	0

(*c*) Have any part of your services or assets made available to him?

[In percent]

	Yes	No	No answer
Total	0.2	98.8	1.0
Very large	1.2	93.9	4.9
Large	1.0	97.0	2.0
Medium	.4	98.4	1.2
Small	0	99.3	.7
Donor influence 50 percent or over	.2	99.1	.7
Donor influence under 50 percent, over 20 percent	.4	98.3	1.2
Donor influence not over 20 percent	(1)	97.9	2.1
Unclassified	0	100.0	0

[1] Less than 0.05 percent.

(*d*) Purchase any securities or other property from you?

[In percent]

	Yes	No	No answer
Total	1.4	97.7	0.8
Very large	2.4	92.7	4.9
Large	4.5	93.5	2.0
Medium	2.6	96.4	1.2
Small	.4	99.2	.4
Donor influence 50 percent or over	1.9	97.5	.6
Donor influence under 50 percent, over 20 percent	.5	98.3	1.2
Donor influence not over 20 percent	0	97.9	2.1
Unclassified	.2	98.2	0

2. (*e*) Sell any securities or other property to you?

[In percent]

	Yes	No	No answer
Total	4.2	94.9	0.9
Very large	4.9	90.2	4.9
Large	7.5	92.5	2.0
Medium	5.9	92.7	1.4
Small	2.9	96.7	.4
Donor influence 50 percent or over	5.0	94.3	.7
Donor influence under 50 percent, over 20 percent	5.3	93.5	1.2
Donor influence not over 20 percent	.8	97.0	2.1
Unclassified	.2	99.8	0

(*f*) Receive any of your income or corpus in other transactions?

[In percent]

	Yes	No	No answer
Total	0.4	98.7	0.9
Very large	1.8	93.3	4.9
Large	1.5	96.0	2.5
Medium	1.0	97.6	1.4
Small	.0	99.6	.4
Donor influence 50 percent or over	.4	98.9	.7
Donor influence under 50 percent, over 20 percent	.4	98.3	1.2
Donor influence not over 20 percent	.6	97.3	2.1
Unclassified	0	100.0	0

3. During the period covered by your 1962 Form 990–A, did—

Any of the officials of your organization, or

The brothers, sisters, spouses, ancestors, or lineal descendants of the officials, or

Corporations owned (50 percent or more of voting stock or 50 percent or more of value of all stock) directly or indirectly, by the officials, or

Partnerships of other unincorporated business ventures in which the officials owned 50 percent or more of the capital interests or profits interests—

(*a*) Borrow any part of your cash, securities, or other property?

[In percent]

	Yes	No	No answer
Total	0.3	94.7	[1] 5.0
Very large	3.0	94.5	2.4
Large	0	97.0	3.0
Medium	.4	95.1	4.5
Small	.2	94.2	5.6
Donor influence 50 percent or over	.4	98.2	1.4
Donor influence under 50 percent, over 20 percent	.2	99.8	0
Donor influence not over 20 percent	.1	96.9	3.1
Unclassified	0	0	100.0

[1] Includes cases where no questionnaire was received.

(*b*) Lend any cash, securities, or other property to you?

[In percent]

	Yes	No	No answer
Total	1.6	93.5	[1] 5.0
Very large	.2	97.4	2.4
Large	1.5	95.5	3.0
Medium	2.0	93.3	4.7
Small	1.3	93.4	5.3
Donor influence 50 percent or over	2.0	96.7	1.3
Donor influence under 50 percent, over 20 percent	1.1	89.9	0
Donor influence not over 20 percent	(2)	96.9	3.1
Unclassified	0	0	100.0

[1] Includes cases where no questionnaire was received.

[2] Less than 0.05 percent.

3. (*c*) Have any part of your services or assets (other than compensation for personal services reported on schedule A of your 1962 Form 990-A) made available to them?

[In Percent]

	Yes	No	No answer
Total	0.2	94.7	[1] 5.1
Very large	.1	97.5	2.4
Large	.5	96.5	3.0
Medium	.4	94.9	4.7
Small	0	94.4	5.6
Donor influence 50 percent or over	.2	98.5	1.3
Donor influence under 50 percent, over 20 percent	.4	99.6	0
Donor influence not over 20 percent	0	96.1	3.9
Unclassified	0	0	100.0

[1] Includes cases where no questionnaire was received.

(*d*) Purchase any securities or other property from you?

[In percent]

	Yes	No	No answer
Total	0.6	94.3	[1] 5.0
Very large	0	97.6	2.4
Large	1.5	95.5	3.0
Medium	.6	94.5	4.9
Small	.4	94.3	5.3
Donor influence 50 percent or over	.7	97.8	1.5
Donor influence under 50 percent, over 20 percent	0	100.0	0
Donor influence not over 20 percent	.4	96.9	2.6
Unclassified	0	0	100.0

[1] Includes cases where no questionnaire was received.

(*e*) Sell any securities or other property to you?

[In percent]

	Yes	No	No answer
Total	1.1	93.9	[1] 5.0
Very large	3.0	94.6	2.4
Large	0	97.0	3.0
Medium	1.6	93.5	4.9
Small	.9	93.8	5.3
Donor influence 50 percent or over	1.2	97.3	1.5
Donor influence under 50 percent, over 20 percent	.2	99.8	0
Donor influence not over 20 percent	1.2	96.1	2.6
Unclassified	0	0	100.0

[1] Includes cases where no questionnaire was received.

(*f*) Receive any of your cash, securities, or other property in other transactions?

[In percent]

	Yes	No	No answer
Total	0.5	94.5	[1] 5.0
Very large	1.2	96.4	2.4
Large	.5	96.5	3.0
Medium	.2	94.9	4.9
Small	.7	94.0	5.3
Donor influence 50 percent or over	.7	97.9	1.4
Donor influence under 50 percent, over 20 percent	.1	99.9	0
Donor influence not over 20 percent	0	96.9	3.1
Unclassified	0	0	100.0

[1] Includes cases where no questionnaire was received.

4. During the period covered by your 1962 Form 990-A, did your organization hold 10 percent or more of any class of stock in any corporation?

[In percent]

	Yes	No	No answer
Total	7.3	88.9	3.8
Very large	44.6	53.0	2.4
Large	20.4	77.5	2.0
Medium	11.0	85.1	3.9
Small	3.3	92.7	4.0
Donor influence 50 percent or over	8.5	91.2	.3
Donor influence under 50 percent, over 20 percent	6.9	93.1	0
Donor influence not over 20 percent	3.0	96.2	.7
Unclassified	0	0	100.0

Source: 1964 Treasury Department Survey of Private Foundations.

9. Foundation payout ratios to assets

Tables 14 and 15 expand upon the information contained in table 12 as to the relationships between grants and net worth of foundations and between ordinary income and net worth. Table 14 shows the percentage of foundations whose total grants are equal to or less than various percentages of net worth. In the top line, for example, the table shows that 10 percent of all foundations in 1962 paid out as grants, including the cost of distributing grants, 1 percent or less of their market net worth. An additional 12 percent of foundations paid out more than 1 percent but less than 3 percent of market net worth. Combining these groups, as is done in the table, 22 percent of all foundations paid out 3 percent or less of their market net worth. Forty percent of all foundations paid out as grants 6 percent or less of their market net worth. It would appear reasonable to interpolate between these figures, and thus it could be estimated that 25 percent of all foundations paid out as grants less than 3½ percent of market net worth. These ratios of grants to net worth are tabulated for various degrees of donor influence and for various sizes of foundations.

Table 15 provides similar information about the relationship between ordinary income and net worth. Of all foundations, 3 percent had no ordinary income. An additional 26 percent had ordinary income between zero and 1 percent of market net worth, making 29 percent that had an ordinary income rate of return of 1 percent or less. A total of 57 percent had a rate of 3 percent or less, and only 10 percent had a return of over 6 percent. Generally, foundations with high donor influence had lower rates of return than other foundations. Similarly, large foundations had better rates of return than small ones. (Many small foundations, which operate as conduits, normally hold their assets in cash.)

TABLE 14.—*Percent of foundations in various categories whose total grants were less than certain percentages of net worth*

	Foundations whose grants were less than—							
	1 percent—	3 percent—	6 percent—	10 percent—	1 percent—	3 percent—	6 percent—	10 percent—
	of market net worth				of book net worth			
All foundations	10	22	40	[1] 52	9	19	38	50
Foundations with donor-related influence—								
Over 50 percent	7	18	34	47	7	16	33	46
33 percent to 50 percent	15	35	59	64	15	28	51	61
20 percent to 33 percent	21	43	57	59	21	41	52	58
0 to 20 percent	21	37	63	72	19	30	38	66
Very large	5	29	76	93	5	14	54	81
Large	4	24	57	76	2	14	49	70
Medium	6	22	50	66	6	19	46	65
Small	12	21	33	41	12	20	32	40
All foundations except small:								
Total	5	22	51	68	5	18	48	66
Foundations with donor-related influence—								
Over 50 percent	4	20	48	67	4	16	45	64
20 percent to 50 percent	10	39	66	74	10	26	57	72
0 to 20 percent	8	25	60	72	8	19	56	71

[1] The remaining 48 percent of foundations contibuted 10 percent or more of their market net worth, 60 percent contributed 6 percent or more, 78 percent contributed 3 percent or more, etc.

Source: 1964 Treasury Department Survey of Private Foundations.

TABLE 15.—*Percent of foundations in various categories whose ordinary incomes were less than certain percentages of market net worth*

	Foundations whose ordinary incomes were less than—				
	0 percent—	1 percent—	3 percent—	6 percent—	10 percent—
	of market net worth				
All foundations	3	29	57	90	94
Foundations with donor-related influence—					
Over 50 percent	2	31	59	91	94
33 percent to 50 percent	7	31	58	90	96
20 percent to 33 percent					
Under 20 percent	3	19	45	87	98
Very large foundations	0	6	31	89	98
Large foundations	1	5	22	89	93
Medium foundations	4	13	44	91	95
Small foundations	2	40	66	90	98

Source: 1964 Treasury Department Survey of Private Foundations.

A certain number of foundations are so-called conduit foundations which are organized simply to receive contributions and more or less immediately distribute these to charitable recipients. These foundations are likely to have very little in the way of net worth, and almost necessarily their ratio of total grants to net worth would be very high. One device for separating out many of the conduit foundations is to eliminate from consideration all foundations with total assets of less than $100,000. The resulting calculations are shown on the bottom four lines of table 14. Looking at the line for the total of all foundations with assets of over $100,000, it will be seen that the percentage of foundations that distributed in grants less than 1 percent of market net worth is only 5 percent. The percentage of foundations distributing less than 3 percent of market net worth is 22 percent whether or not the small foundations are included. The percentage of foundations distributing less than 6 percent of net worth rises from 40 to 51 percent when the small foundations are excluded. The percentage distributing less than 10 percent of net worth rises from 52 to 68 percent when the small foundations are excluded.

Another attempt was made to eliminate the influence of conduit foundations on asset payout ratios. This was done by preparing an analysis of the data limited only to those foundations that reported no contributions received in 1962. As in the prior tabulations, the sample results for large, medium, and small foundations with no contributions have been blown up. It is estimated that about one-third of foundations had no contributions received in 1962. Since the Ford Foundation would be included in this category, and would tend to dominate the figures, table 16, which presents some summary figures on foundations receiving no contributions in 1962, contains the data excluding the Ford Foundation. This subsample, even though it is based only on about 400 foundation returns, is quite useful in illustrating the behavior pattern of foundations with respect to the handling of income.

TABLE 16.—*Aggregate data on foundations reporting no contributions received in 1962*

[Dollar amounts in millions]

	Foundations with no contributions received in 1962		Percent of donor-related influence over investment policy		
	All except Ford	Ford	Over 50 percent	Over 33 percent—not over 50 percent	Under 30 percent, all except Ford
Number of foundations	4,595	1	3,155	333	1,107
Net ordinary income (after expenses)	$149.8	$136.4	$56.4	$10.7	$82.7
Capital gain	45.7	327.2	20.4	4.9	20.3
Total income	195.5	463.6	76.8	15.6	103.0
Grants from current and accumulated income [1]	158.7	233.4	66.8	12.6	79.4
Grants from capital [1]	26.5		15.0	1.2	10.3
Total grants	185.2	233.4	81.8	13.8	89.7
Net worth (ledger)	2,723.0	2,217.0	1,051.0	234.0	1,487.0
Net worth (market)	4,010.0	3,114.0	1,612.0	342.0	2,056.0

[1] Includes cost of making grants.

Source: 1964 Treasury Department Survey of Private Foundations.

It is interesting that in the aggregate, foundations that received no contributions still made grants in excess of current income. An appreciable amount of grants were presumably in excess of accumulated income and were therefore marked as coming from capital. In the aggregate, grants were not as large as the sum of ordinary income and capital gains. In the aggregate figures the volume of grants relative to income was higher for those foundations where donor influence exceeded 50 percent than it was for others.

Table 17 shows some percentage calculations based on the calculation of ratios between grants to net worth and ordinary income to net worth for those foundations receiving no current contributions in 1962. As would be expected, a higher percentage of these foundations would be affected by a requirement that grants be a certain percentage of net worth than was true when this requirement was tested against all foundations. In this case about 40 percent of these foundations would be affected by a 3½ percent payout requirement while the percentage was about 25 percent for all foundations. It might be noted also that the earnings experience is somewhat better when one looks at foundations without contributions because, by and large, less of the assets tend to be invested in highly liquid forms as might be appropriate where the foundation is serving only as a conduit. Most likely about 40 percent of these foundations have a current earnings rate in terms of ordinary income in excess of 3½ percent of market net worth. It would be expected that those foundations whose rate of return on net worth was relatively high should pretty much correspond to those foundations whose ratio of grants to net worth was also high. Nevertheless there would be some of the foundations whose rate of return was in exeess of 3½ percent who would not have made a correspondingly high ratio of grants to net worth. The combined test of a volume of grants equal to the higher of 3½ percent of market net worth or ordinary income might affect about 50 percent of these foundations.

TABLE 17.—*Percent of foundations receiving no current contributions whose total grants and ordinary income were less than certain percentages of net worth*

	Foundations whose grants were less than—				Foundations whose ordinary income was less than—				
	1 percent—	3 percent—	6 percent—	10 percent—	0	1 percent—	3 percent—	6 percent—	10 percent—
	of market net worth				of market net worth				
All foundations receiving no current contributions	19	35	59	69	2	24	49	87	92
Foundations with no contributions received whose donor related influence was—									
over 50 percent	17	29	49	61	2	29	53	88	92
33 percent to 50 percent	27	39	67	82	6	20	40	88	94
0 to 33 percent	24	49	84	98	1	11	41	84	92
Foundations with assets over $100,000 with no contributions received whose donor related influence was—									
over 50 percent	8	24	62	77	3	10	36	91	94
33 percent to 50 percent	5	38	74	79	0	5	42	99	100
0 to 33 peacent	10	33	78	87	2	5	25	87	94

Source: 1964 Treasury Department Survey of Private Foundations.

Even in this group of foundations with no contributions received in 1962, it is likely that some conduit foundations are included, that is, foundations which were distributing contributions received in 1961. Including these in the tabulations continues to distort the relationship between capital and payout. (Nearly half of the small foundations with donor influence over 50 percent distributed over 10 percent of net worth in grants and thus apparently got contributions in previous years. None of the small foundations with donor influence less than 33 percent without contributions showed this pattern of contributions over 10 percent of net worth.) A more revealing set of figures on the relationship of grants to market net worth for foundations not receiving contributions is shown in the bottom bank of table 17 which eliminates foundations receiving contributions in 1962 and foundations with assets under $100,000. In these figures foundations with high donor-related influence show a slightly better payout performance, despite showing a somewhat poorer record on earning income. The differences in payout, however, are quite small, and at this point the sample of foundations receiving no contributions in 1962 and having assets over $100,000 is fairly small. The sample includes 142 foundations in the over-50-percent category, 31 in the 33- to 50-percent category, and 117 in the under-33-percent category.

It is not clear why, in these various sets of ratios, the foundations with a high proportion of donor-related trustees appear to show a somewhat better payout performance. It may be that this group contains many situations where future contributions from the donor or his family are still expected which induces the trustees to be more liberal with available assets.

10. Foundation involvement in business

Table 18 lists those foundations with assets of $10 million or more which own 20 percent or more of the stock of business corporations. The table sets forth the foundations' holding of the stock of the businesses as of the end of 1962, cash dividends paid on such stock in 1962, yield, and the total assets of the foundations as of the end of 1962. This table was prepared from data obtained from the Form 990-A and supplemental questionnaire.

TABLE 18.—*Ownership of more than 20 percent of the stock of business corporations by foundations with assets $10 million or more* [1]—Continued

Name of foundation	Stockholding, end of 1962	Approximate value of stock, end of 1962	1962 cash dividends	Yield	Total assets of foundation, end of 1962
I. Donor and donor-related parties, represent ½ or more of foundation's trustees, etc., who control investment policy.—Continued				*Percent*	
Moody foundation	50 percent of Gal-Tex Hotel Corp. common stock	[3] $1.4	0	0	[3] $180.3
	50 percent of Silver Lake Ranches Co. common stock	[3] .7	0	0	
	100 percent of Texas National Hotel Co. common stock	[3] 1.3	0	0	
	35 percent of American National Insurance Co. common stock	[3] 167.3	$2.42	1.4	
	44 percent of Hotel Wade Hampton, Inc., common stock	[3] .3	.00	0	
	40 percent of Moody National Bank common stock	[3] .8	.01	1.3	
	35 percent of National Hotel Co. common stock	[3] 2.5	.00	0	
Charles Stewart Mott Foundation	100 percent of D. M. Christian Co. common stock	[3] .4	.00	0	[3] 112.3
	100 percent of J. W. Knapp Co. common stock	[3] 4.7	.00	0	
	100 percent of Smith Bridgman & Co. common stock	[3] 3.2	.00	0	
	100 percent of L. W. Robinson Co. common stock	[3] 1.0	.00	0	
	61 percent of Wayne Oakland Bank common stock	[3] 7.6	.00	0	
	48 percent of U.S. Sugar Corp. common stock	[3] 23.7	.75	3.2	
Sid W. Richardson Foundation	100 percent of Richardson Oils, Inc. common stock	[3] 11.7	0	0	[3] 95.0
	75 percent of Sid W. Richardson Carbon & Gasoline Co. common stock.	[3] 7.4	0	0	
	69 percent of Texas State Network, Inc., common stock	[3] 1.3	0	0	
	49 percent of Citizens Hotel Co. common stock	[3] .7	0	0	
Rogosin Foundation	23 percent of Beaunit Corp. common stock	[3] 9.7	.53	5.5	[3] 10.5
Scriven Foundation	100 percent of Leatherstocking Corp. capital stock	[3] 3.0	0	0	[3] 14.4
William Volker Fund	23 percent of Joanna Western Mills Co. common stock	[3] 1.5	.08	5.3	[3] 14.3
William K. Warren Foundation	34 percent of Natural Gasoline Co. common stock	[3] 2.3	.01	.4	[3] 35.5
Woods Charitable Fund	24 percent of Sahara Coal Co. common stock	[3] 2.1	.48	22.9	[3] 13.4
	Preferred stock of Sahara Coal Co.; foundation's holding of preferred stock represents 14 percent of value of all shares of Sahara Coal Co. stock.	[3] 2.3	.12	5.2	
II. Donor and donor-related parties represent more than ⅓, but less than ½ of foundation's trustees, etc., who control investment policy:					
Louis Calder Foundation	30 percent of Perkins-Goodwin common stock	[3] 9.1	.02	.2	[3] 46.1
John A. Hartford Foundation	33 percent of Great A & P Tea Co. common stock	[3] 314.3	10.34	3.3	[3] 360.2
William Randolph Hearst Foundation	Nonvoting common stock of Hearst Corp.; foundation's holding represents 54 percent of value of all shares of Hearst Corp. stock.	[3] 43.6	.15	.3	[3] 43.3
Charles F. Kettering Foundation	30 percent of C. F. Kettering, Inc., common stock	[3] 62.8	2.79	4.4	[3] 74.0
Samuel Roberts Noble Foundation	100 percent of Noble Drilling Corp. common stock	[3] 7.3	0	0	[3] 32.8
	100 percent of Samedan Oil Co. common stock	[3] 17.0	0	0	
	100 percent of B. F. Walker, Inc., common stock	[3] .5	0	0	
	50 percent of Lenox Square, Inc., common stock	[3] 1.0	0	0	
	75 percent of preferred stock of Lenox Square, Inc.; foundation's holding of preferred stock represents 25 percent of value of all classes of Lenox Square, Inc., stock.	[3] .8	0	0	

TABLE 18.—*Ownership of more than 20 percent of the stock of business corporations by foundations with assets $10 million or more* [1]

[In millions of dollars]

Name of foundation	Stockholding, end of 1962	Approximate value of stock, end of 1962	1962 cash dividends	Yield	Total assets of foundation, end of 1962
I. Donor and donor-related parties represent ½ or more of foundation's trustees, etc., who control investment policy:				*Percent*	
Alcoa foundation	24 percent of Nalco Chemical Co. common stock	[2] $26.1	$0.58	2.2	[2] $43.3
Winfield Baird foundation	24 percent of Skyline Oil Co. common stock	[2] 2.1	0	0	[2] 17.5
Charles Ulrick and Josephine Bay Foundation	73 percent of voting power (through common and voting preferred stock) of Connecticut Railway and Lighting Co.	[2] 6.6	.36	5.5	[2] 10.1
Cannon foundation	39 percent of Imperial Cotton Mills Co. common stock	[2] .6	.01	1.7	[2] 25.2
	42 percent of Social Circle Cotton Mills Co. common stock	[2] .6	.01	1.7	
	46 percent of Amazon Cotton Mills Co. common stock	[2] 1.0	.03	3.0	
	Preferred and nonvoting common stock of Concord Telephone Co.; foundation's holding represents 33 percent of value of all shares of Concord Telephone Co. stock.	[2] 1.0	.06	6.0	
Amon G. Carter Foundation	100 percent of Carter Foundation Production Co. common stock.	[2] 1.5	0	0	[2] 33.2
	50 percent of Citizens Hotel Corp. common stock	[2] .6	0	0	
Danforth Foundation	23 percent of Ralston Purina Co. common stock	[2] 97.4	2.43	2.5	125.2
De Rance, Inc	47 percent of Miller Brewing Co. common stock	[2] 15.0	.44	2.9	[2] 15.0
El Pomar Foundation	100 percent of common stock and 86 percent of preferred stock of El Pomar Investment Co.	[2] 50.8	.66	1.3	[2] 60.5
	100 percent of Broadmoor Drug Co. common stock	[2] .1	0	0	
General Electric Foundation	30 percent of Stevens Paper Mills, Inc., common stock	[2] 1.3	.04	3.1	[2] 25.0
Herrick Foundation	23 percent of Tecumseh Products Co. common stock	[2] 25.1	1.0	4.0	[2] 25.2
Houston Endowment, Inc	100 percent of Commercial & Industrial Life Insurance Co. common stock.	[2] 1.5	.03	2.0	[2] 90.4
	100 percent of Commerce Co. common stock	[2] 15.2	.12	.8	
	94 percent of Commerce Co. preferred stock	[2] 2.8	.11	3.9	
	51 percent of Airline State Bank, Houston, common stock	[2] .5	0	0	
	42 percent of Reagan State Bank, Houston, common stock	[2] .5	0	0	
	26 percent of National Bank of Commerce, Houston common stock.	[2] 27.8	.42	1.5	
Kresge foundation	100 percent of Kresge-Newark, Inc. common stock	[2] 3.0	.00	0	
	34 percent of S. S. Kresge Co. common stock	[2] 40.1	2.84	7.1	
LeTourneau foundation	86 percent of R. G. LeTourneau, Inc. common stock	[2] 4.7	0	0	[2] 11.6
Lilly Endowment, Inc	45 percent of Eli Lilly and Co. common stock	[2] 108.1	3.39	3.1	[2] 151.5
	Nonvoting common stock of Eli Lilly and Co.; foundation's holding of nonvoting common stock represents 7 percent of value of all shares of Eli Lilly and Co. stock.	[2] 42.0	1.32	3.1	

See footnotes at end of table, p. 99.

III. Donor and donor-related parties represent more than ⅓, but not more than ½ of foundation's trustees, etc. who control investment policy:					
Blakely-Braniff Foundation	100 percent of Girard Insurance Group common stock	[3] 12.0	0	0	[3] 37.1
Duke Endowment	57 percent of Duke Power Co. common stock	[3] 306.6	11.1	3.0	[3] 475.4
	82 percent of Duke Power Co. preferred stock	[3] .4	.02	5.0	
	22 percent of Piedmont & Northern Ry. Co. common stock	[3] 2.3	.13	5.7	
Fred L. Emerson Foundation	100 percent of Duncar Corp. common stock	[3] .9	.02	2.2	[3] 20.6
	100 percent of Enna Jettick Corp. capital stock	[3] .4	0	0	
Lettie Pate Evans Foundation	42 percent of Whitehead Holding Co. common stock	[3] 7.5	.58	7.7	[3] 12.2
Louis W. & Maud Hill Family Foundation	100 percent of Hill Foundation Co. common stock	[3] 1.5	0	0	[3] 59.4
Samuel H. Kress Foundation	42 percent of S. H. Kress & Co. common stock	[3] 18.0	.25	1.4	[3] 28.5
Olin Foundation	100 percent of Federal Cartridge Corp. common stock	[3] 14.3	1.02	7.1	[3] 54.7
IV. Donor and donor-related parties represent ⅓ or less of foundation's trustees, etc. who control investment policy:					
Altman Foundation	95 percent of B. Altman & Co. capital stock	[3] 35.1	.46	1.3	[3] 39.6
Callaway Foundation	100 percent of Callaway Mills Co. common stock	[3] 37.7	.00	0	[3] 42.1
Samuel S. Fels Fund	86 percent of Fels & Co. common stock	[3] 2.9	.02	.7	[3] 10.2
Ford Foundation	Class A (nonvoting) stock of Ford Motor Co.; foundation's holding of class A stock represents 46 percent of the value of all shares of Ford Motor Co. stock.	[3] 2,095.2	91.15	4.4	[3] 3,320.4
Josephine E. Gordon Foundation	100 percent of Gordon Baking Co. common stock	[3] 9.0	.03	.3	[3] 9.0
Gulf Oil Foundation	100 percent of Pontiac Refining Co. common stock	[3] 32.2	.75	2.3	[3] 32.6
Charles Hayden Foundation	100 percent of Hayfund, Inc., capital stock	[3] .6	.00	0	[3] 76.2
Independence Foundation	Preferred nonvoting stock in Band-It, Inc.; foundation's holding of preferred stock represents 79 percent of value of all shares of Band-It, Inc., stock.	[3] .8	.05	6.3	[3] 20.3
W. K. Kellogg Foundation (and W. K. Kellogg Foundation Trust).	45 percent of Kellogg Co. preferred stock	[3] 4.6	.19	4.1	[3] 380.3
	51 percent of Kellogg Co. common stock	[3] 334.6	7.2	2.2	
Pew Memorial Trust	100 percent of Minerals Development Co. common stock	[3] 1.5	.99	66.0	[3] 141.5
	21 percent of Sun Oil Co. common stock	[3] 138.2	3.10	2.2	
Pittsburgh Plate Glass Foundation	46 percent of Cavanaugh Co. common stock	[3] .4	0	0	[3] 16.1
Research Corp.	100 percent of Research Cottrell, Inc. common stock	[3] 2.9	0	0	[3] 11.4
Alexander & Margaret Stewart Trust	47 percent of Midland Building Industries, Inc., common stock.	[3] 1.2	0	0	[3] 7.9
	50 percent of Midland Building Industries, Inc., preferred stock.	[3] .3	.01	3.3	
Robert A. Welch Foundation	70 percent of Mound Co. common stock	[3] 1.2	.05	4.2	[3] 55.8
	64 percent of the preferred stock of Mound Co.; foundation's holding of preferred stock represents 28 percent of value of all shares of Mound Co. stock.	[3] .8	.04	5.0	

---

[1] This table excludes stock of corporations which, it appears, hold assets, such as real estate, the income from which would not be treated as unrelated business income if the asset were owned directly by the foundation. It also excludes stock of corporations where the value of the stock in excess of 20 percent of the corporation's outstanding stock is less than $100,000.

[2] Market value.

[3] Value on foundation's books (value of assets at date of acquisition by foundation).

Source: 1964 Treasury Department Survey of Private Foundations. Similar information may be found in the Patman Report, 1st installment, supra, See pp. 35–50.

11. Foundations and type of charity.

Table 19 provides some estimates of the grants of foundations by philanthropic field involved. The estimates are by the Foundation Library Center. These are strikingly different in distribution from individual contributions in the aggregate, involving a much lower contribution to religion and higher contributions to education and international activities. This cannot be taken directly as a measure of the redirection effect of foundations. Foundations handle the contributions of the wealthy, by and large, and the pattern of reduced contribution to religion and increased contribution to education among the wealthy is seen in table 4.

TABLE 19.—*Grants of 6,007 foundations, by major fields in 1962* [1]

[Dollar figures in millions]

Fields	176 large foundations [2]	847 intermediate foundations [3]	4,984 small foundations [4]	6,007 total foundations
Education	$201	$76	$38	$315
Percent	46	46	21	40
International activities	$74	$28	$4	$106
Percent	17	17	2	14
Welfare	$26	$10	$60	$96
Percent	6	6	34	12
Health	$44	$16	$30	$90
Percent	10	10	17	12
Sciences	$61	$23	$3	$86
Percent	14	14	1	11
Religion	$9	$3	$34	$46
Percent	2	2	19	6
Humanities	$22	$8	$10	$40
Percent	5	5	6	5
Total	$436	$165	$179	$779
Percent of grants	56	21	23	100

[1] Possessing assets of $10,000,000 or more.

[2] Possessing assets between $1,000,000 and $10,000,000.

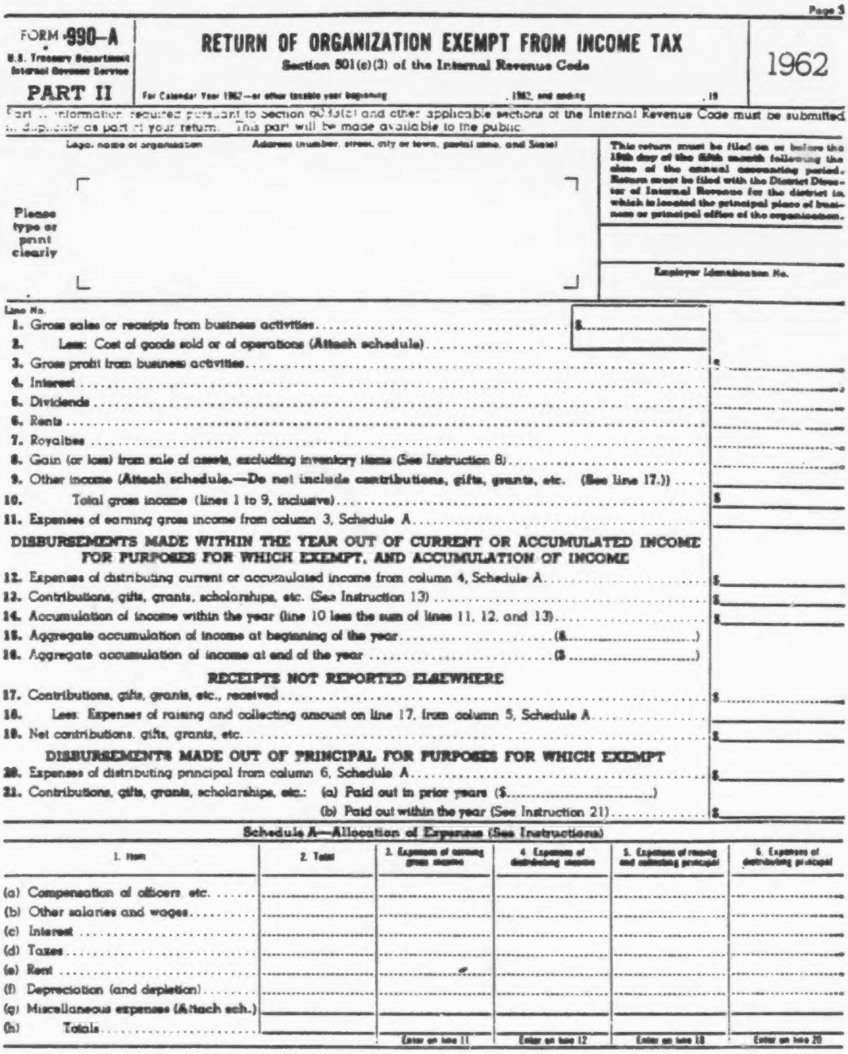
[3] Possessing assets under $1,000,000.

[4] The 6,007 foundations included in the 1962 directory. Generally, these had assets over $100,000.

Source: "The Foundation Directory," ed. 2, p. 44.

NOTE.—Detail may not add to totals because of rounding.

APPENDIX A—EXHIBIT 1



Page 3

FORM 990-A
U.S. Treasury Department
Internal Revenue Service
PART II

RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX
Section 501(c)(3) of the Internal Revenue Code

1962

For Calendar Year 1962—or other taxable year beginning ...., 1962, and ending ...., 19....

Part II information required pursuant to section 6033(a) and other applicable sections of the Internal Revenue Code must be submitted in duplicate as part of your return. This part will be made available to the public.

Please type or print clearly

Legal name of organization
Address (number, street, city or town, postal zone, and State)

This return must be filed on or before the 15th day of the fifth month following the close of the annual accounting period. Return must be filed with the District Director of Internal Revenue for the district in which is located the principal place of business or principal office of the organization.

Employer Identification No.

Line No.

1. Gross sales or receipts from business activities.......... $..........
2. Less: Cost of goods sold or of operations (Attach schedule)..........
3. Gross profit from business activities.......... $..........
4. Interest..........
5. Dividends..........
6. Rents..........
7. Royalties..........
8. Gain (or loss) from sale of assets, excluding inventory items (See Instruction 8)..........
9. Other income (Attach schedule.—Do not include contributions, gifts, grants, etc. (See line 17.))..........
10. Total gross income (lines 1 to 9, inclusive).......... $
11. Expenses of earning gross income from column 3, Schedule A..........

DISBURSEMENTS MADE WITHIN THE YEAR OUT OF CURRENT OR ACCUMULATED INCOME FOR PURPOSES FOR WHICH EXEMPT, AND ACCUMULATION OF INCOME

12. Expenses of distributing current or accumulated income from column 4, Schedule A.......... $
13. Contributions, gifts, grants, scholarships, etc. (See Instruction 13).......... $
14. Accumulation of income within the year (line 10 less the sum of lines 11, 12, and 13).......... $
15. Aggregate accumulation of income at beginning of the year..........($..........)
16. Aggregate accumulation of income at end of the year..........($..........)

RECEIPTS NOT REPORTED ELSEWHERE

17. Contributions, gifts, grants, etc., received.......... $..........
18. Less: Expenses of raising and collecting amount on line 17, from column 5, Schedule A..........
19. Net contributions, gifts, grants, etc.......... $

DISBURSEMENTS MADE OUT OF PRINCIPAL FOR PURPOSES FOR WHICH EXEMPT

20. Expenses of distributing principal from column 6, Schedule A.......... $
21. Contributions, gifts, grants, scholarships, etc.: (a) Paid out in prior years ($..........)
(b) Paid out within the year (See Instruction 21).......... $

Schedule A—Allocation of Expenses (See Instructions)

1. Item	2. Total	3. Expenses of earning gross income	4. Expenses of distributing income	5. Expenses of raising and collecting principal	6. Expenses of distributing principal
(a) Compensation of officers, etc.					
(b) Other salaries and wages					
(c) Interest					
(d) Taxes					
(e) Rent					
(f) Depreciation (and depletion)					
(g) Miscellaneous expenses (Attach sch.)					
(h) Totals					
		Enter on line 11	Enter on line 12	Enter on line 18	Enter on line 20

Schedule B.—BALANCE SHEETS (See Instructions)

	Beginning of Year		End of Year	
	Amount	Total	Amount	Total
ASSETS				
1. Cash				
2. Accounts receivable				
Less: Reserve for bad debts				
3. Notes receivable				
Less: Reserve for bad debts				
4. Inventories				
5. Investments in governmental obligations				
6. Investments in nongovernmental bonds, etc.				
7. Investments in corporate stocks (See Instructions)				
8. Mortgage loans				
9. Other investments **(Attach schedule)**				
10. Depreciable (and depletable) assets **(Attach schedule)**				
Less: Reserve for depreciation (and depletion)				
11. Land				
12. Other assets **(Attach schedule)**				
13. Total assets				
LIABILITIES AND NET WORTH				
14. Accounts payable				
15. Contributions, gifts, grants, etc., payable				
16. Bonds, notes, and mortgages payable				
17. Other liabilities **(Attach schedule)**				
18. Capital stock: (a) Preferred stock				
(b) Common stock				
19. Membership certificates				
20. Principal or other capital				
21. Reserves **(Attach schedule)**				
22. Accumulated income or earned surplus:				
(a) Attributable to ordinary income				
(b) Attributable to gains from sale of assets				
23. Total liabilities and net worth				

1. Date of current exemption letter ....

2. Attach a detailed statement of the nature of your business, charitable, and all other activities.

3. Was a Form 990-A filed for the preceding year? .... ☐ Yes ☐ No

If "Yes," where filed? ....

4. Have you filed a tax return on Form 990-T for this year? ... ☐ Yes ☐ No

If "Yes," where filed? ....

5. What is the legal form of your organization (corporation, trust, unincorporated association, etc.)? ....

6. In what year was your organization formed? ....

In what State or country? ....

7. If successor to previously existing organization(s), give name(s) and address(es) of the predecessor organization(s) ....

....

8. If you have capital stock issued and outstanding, state with respect to each class of stock—

(a) The number of shares outstanding ....

(b) The number of shares held by individuals ....

(c) The number of shares held by organizations ....

(d) The number of shareholders at end of year ....

(e) Whether any dividends may be paid .... ☐ Yes ☐ No

9. If you acquired capital assets out of income, attach itemized list and amount thereof.

10. Have any changes not previously reported to the Internal Revenue Service been made in your articles of incorporation or bylaws or other instruments of similar import? .... ☐ Yes ☐ No

If "Yes," attach a copy of the amendments.

11. Have you had any sources of income or engaged in any activities not previously reported to the Internal Revenue Service? .... ☐ Yes ☐ No

If "Yes," attach detailed statement.

12. Did you hold any real property for rental purposes with respect to which there is an indebtedness incurred in acquiring the property or in making improvements thereto or which was acquired subject to a mortgage or similar lien? .... ☐ Yes ☐ No

If "Yes," attach detailed statement.

13. Have you during the year either advocated or opposed (including the publishing or distributing of statements) any legislation, national, State, or local? .... ☐ Yes ☐ No

If "Yes," attach a detailed description of such activities and copies of any such statements.

14. Have you during the year participated in, or intervened in (including the publishing or distributing of statements) any political campaign on behalf of any candidate for public office? .... ☐ Yes ☐ No

If "Yes," attach a detailed description of such activities and copies of any such statements.

15. After July 1, 1950, did—
The creator of your organization, or
A contributor to your organization, or
A brother or sister (whole or half blood), spouse, ancestor, or lineal descendant of such creator or contributor, or
A corporation owned (50 percent or more of voting stock or 50 percent or more of value of all stock) directly or indirectly by such creator or contributor

(a) Borrow any part of your income or corpus? .... ☐ Yes ☐ No

(b) Receive any compensation for personal services from you? .... ☐ Yes ☐ No

(c) Have any part of your services or assets made available to him? .... ☐ Yes ☐ No

(d) Purchase any securities or other property from you? .. ☐ Yes ☐ No

(e) Sell any securities or other property to you? .... ☐ Yes ☐ No

(f) Receive any of your income or corpus in other transactions? .... ☐ Yes ☐ No

If answer to any question is "Yes," attach detailed statement unless previously reported.

16. Do you hold 10 percent or more of any class of stock in any corporation? .... ☐ Yes ☐ No

If "Yes," you must submit the information required by the instructions for Schedule B.

INSTRUCTIONS FOR FORM 990-A (1962)

RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX

Section 501(c)(3) of the Internal Revenue Code

GENERAL INSTRUCTIONS

A. Who must file Form 990-A.—An annual statement, Part I of this form, of gross income, receipts, disbursements, etc., is required by law of every organization which is exempt from tax as described in section 501(c)(3) of the Code, excepting only (1) a religious organization; (2) an educational organization if it normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at the place where its educational activities are regularly carried on; (3) a charitable organization, or an organization for the prevention of cruelty to children or animals, if supported in whole or in part by funds contributed by the United States or any State or political subdivision thereof, or primarily supported by contributions of the general public; (4) or an organization operated, supervised, or controlled by or in connection with a religious organization described in section 501(c)(3). In addition to Part I, such organizations are also required by law to file certain information on Part II of this form which is made available to the public. In connection with Part II of this form all required information must be submitted except that the organization may omit any information relating to a trade secret, patent, process, style of work, or apparatus which would adversely affect the organization, or any information which would adversely affect the national defense. In such cases, the organization must submit this type of information only with Part I, together with a statement identifying which items are being withheld from Part II and the reasons for doing so. The law provides penalties for failure to furnish the information required by this form.

B. Signature and verification.—The return must be signed either by the president, vice president, treasurer, assistant treasurer or chief accounting officer, or other corporate officer (such as tax officer) who is authorized to sign. A receiver, trustee, or assignee must sign any return which he is required to file on behalf of a corporation. The return must also be signed by any person, firm, or corporation who prepared the return. If the return is prepared by a firm or corporation, it should be signed in the name of the firm or corporation. The verification is not required if the return is prepared by a regular, full-time employee of the organization.

C. Form 990-T.—Section 511 of the Code imposes a tax in case of certain organizations described in sections 401(a) and 501(c)(2), (3), (5), (6), and (17), on income derived (a) from operation of a business enterprise which is unrelated to the purpose for which such organization received an exemption or (b) from certain rentals from property leased to others on a long-term basis. (Use Form 990-T.)

D. Form 1099.—Every organization engaged in a trade or business (which includes for this purpose all exempt functions) making payments in the course of such trade or business of interest, rents, commissions, salaries or wages (not reported on Form W-2), or other fixed or determinable income (including allowances for expenses) of amounts of $600 or more during the calendar year to an individual, a partnership, or a fiduciary shall make returns on Forms 1096 and 1099. (See section 1.6041-1 of the regulations.) Effective January 1, 1963 Forms 1099 and 1096 are required to be submitted for payments of interest aggregating $10 or more. A copy of any information return (Form 1099) is required to be furnished to the payee.

E. Attachments.—The schedules contained on the official form should be used unless the entry spaces provided are not sufficient for your needs. Attachments must contain the name and address of the organization as well as the required information and must follow the format of the schedules and must be presented in the same sequence as the lines of the form.

SPECIFIC INSTRUCTIONS

(References are to lines or schedules on form)

8. Attach a schedule to pages 1, 3, and 5 showing with respect to each asset sold or exchanged: (a) Date acquired, manner of acquisition, date sold, and to whom sold; (b) Gross sales price; (c) Cost, other basis, or value at time of acquisition if donated (state which); (d) Expense of sale and cost of improvements subsequent to acquisition; (e) Depreciation since acquisition; and (f) Gain or loss—(b) plus (e) minus the sum of (c) and (d).

13. Attach a schedule to pages 1, 3, and 5 in support of contributions, gifts, grants, scholarships, etc. showing: (a) each class of activity; (b) separate total for each activity; (c) name and address of donee and amount of distribution to donee; and (d) relationship of donee, if related by blood, marriage, adoption, or employment (including children of employees) to any person or corporation having an interest in the organization such as

creator, donor, director, trustee, officer, etc. Activities should be classified according to purpose in greater detail than merely charitable, educational, religious, or scientific. For example payments for nursing service, for laboratory construction, for fellowships, or for assistance to indigent families should be so identified.

Although the actual distribution of cash, securities or other property is to be entered on this line the expenses in connection with the distributions and those expenses incurred for philanthropic programs operated by the organization itself are not to be included on this line but should be entered on line 12 and in column 4 of Schedule A.

Where the fair market value of the property at the time of disbursement is the measure of the contribution and is used in arriving at the amount to be entered on this line the schedule must also show: (1) description of the contributed property; (2) book value of the contributed property; and (3) the method used to determine the book value. In such case the difference between fair market value and book value should be reflected in the books of account.

17. In all cases where money, securities or other property aggregating $100 or more is received directly or indirectly from one person in one or more transactions during the year attach an itemized schedule to page 1 showing the name, address, date received, and the total amount received from each such person. If the contribution is in the form of property the description and the fair market value of such property shall also be furnished. (The term "person" includes individuals, fiduciaries, partnerships, corporations, associations, and other organizations.)

21. Attach a schedule to pages 3 and 5 for contributions, gifts, grants, scholarships, etc., which were paid out within the year, showing the same information required in instruction 12. For those disbursements made in prior years only the total need be shown.

Schedule A.—Attach a schedule in support of line (a) to pages 1, 3, and 5 for compensation of officers, directors, trustees, etc., showing name, position, time devoted to position, salary, and expense account allowances.

For depreciation attach a schedule to pages 1, 3, and 5 showing: (a) kind of property; (b) date acquired; (c) cost or other basis (exclude land); (d) depreciation taken in prior years; (e) method of computation; (f) rate (%) or life (years), and (g) depreciation this year.

Expenses to be entered in column 2 of Schedule A should be extended to columns 3 through 6 on the basis of accounting records. If such records do not provide for this division, expenses may be divided on any reasonable basis, such as an approximation of the use of a facility or the time spent by an individual.

Schedule B.—The balance sheet should agree with the books of account or any differences should be reconciled.

In all cases where investments in corporate stocks at the close of the taxable year include 10 percent or more of any class of stock of any corporation, attach a schedule to pages 2, 4, and 6 showing: (a) name of corporation, class of stock and whether the stock is voting or nonvoting; (b) number of shares owned of each class at beginning and end of the taxable year; (c) total number of shares outstanding of each class; (d) value of stock as recorded in the books and included in line 7; (e) date acquired; and (f) manner of acquisition.

APPENDIX A—EXHIBIT 2

Bureau of Budget Approval
No. 48-6403
Expires Dec. 31, 1964

QUESTIONNAIRE

TAX-EXEMPT FOUNDATION SURVEY

NAME......
ADDRESS..

Officials, etc.

1. List below the name and position of each official (officer, director, or trustee, etc.), whether or not compensated, of your organization at the end of the period covered by your 1962 Form 990-A. (Please list all officers first, then directors, then trustees, etc.) Use additional sheet if necessary.

	Name	Position	Relationship (see #2 below) None	Relationship (see #2 below) Type	Investment Policy (see #3 below) Yes (1)	Investment Policy (see #3 below) No (2)
1.	____________	____________	☐	____	☐	☐
2.	____________	____________	☐	____	☐	☐
3.	____________	____________	☐	____	☐	☐
4.	____________	____________	☐	____	☐	☐
5.	____________	____________	☐	____	☐	☐

2. For each official listed, indicate by entering the appropriate letter in the column "Relationship - Type" which, if any, of the relationships listed below he bears to the creator of the organization or to a substantial contributor (any person who has contributed $1,000 or more to the organization). If none, check the column "Relationship - None."

(a) He is the creator or a substantial contributor.
(b) He is related by blood, marriage, or adoption to the creator or to a substantial contributor.
(c) He is an employee of the creator or of a substantial contributor.
(d) He is an attorney or accountant of the creator or substantial contributor.
(e) He is an employee of a corporation owned (50 percent or more of voting stock or 50 percent or more of the value of all stock), directly or indirectly, by the creator and/or substantial contributor.
(f) He is an employee of a partnership or other unincorporated business venture in which the creator and/or substantial contributor owns 50 percent or more of the capital interests or profits interests.
(g) He is a person who holds 20 percent or more of the voting stock or 20 percent or more of the value of all stock in any corporation in which the creator and/or substantial contributor (and the wife and children of the creator and/or substantial contributor) holds 20 percent or more of the voting stock or 20 percent or more of the value of all stock.

(Question 2 continued on page 2.)

(h) He is a person who holds 20 percent or more of the capital interests or profits interests in any partnership or other unincorporated business venture in which the creator or substantial contributor (and the wife and children of the creator or substantial contributor) holds 20 percent or more of the capital interests or profits interests.
(i) He has another significant business relationship with the creator or a substantial contributor.

(If the relationship (i) is indicated, please describe briefly on an attached sheet. Such other significant business relationship would, for example, exist where the official is an employee of a corporation or partnership in which the creator or substantial contributor owns 20 percent or more of the stock or capital or profits interests.)

3. Indicate by checking "yes" or "no" in the "Investment Policy" column whether the individual official was authorized to participate in decisions relating to the handling of investments of your organization, or decisions relating to the total amount of income, contributions, and corpus to be invested.

Question 15 on Form 990-A asks whether or not your organization engaged in certain transactions with the creator of the organization, with a substantial contributor to the organization, or with certain parties related to either the creator or a substantial contributor. The following question (4) asks about such transactions with officials of the organization and certain parties related to such officials and deals only with transactions that were not involved in question 15 on Form 990-A. In aswering this question do not take account of any transactions involving individuals who are both creators or contributors (or related to creators or contributors) and officials or related to officials.

4. Transactions with Officers, etc.

During the period covered by your 1962 Form 990-A, did -

-any of the officials of your organization;
-the brothers, sisters, spouses, ancestors, or lineal descendants of the officials;
-corporations owned (50 percent or more of voting stock or 50 percent or more of value of all stock), directly or indirectly, by the officials; or
-partnerships or other unincorporated business ventures in which the officials owned 50 percent or more of the capital interests or profits interests:

	(1) Yes	(2) No
(a) Borrow any part of your cash, securities, or other property?	☐	☐
(b) Lend any cash, securities, or other property to you?	☐	☐
(c) Have any part of your services or assets (other than compensation for personal services reported on Schedule A of your 1962 Form 990-A) made available to them?	☐	☐
(d) Purchase any securities or other property from you?	☐	☐
(e) Sell any securities or other property to you?	☐	☐
(f) Receive any of your cash, securities, or other property in other transactions?	☐	☐

If the answer to any of the questions is "yes," attach a detailed explanation. (Please mark this explanation "Schedule 4.")

NAME.....
ADDRESS..

5. Contributions Received During the Period Covered by Form 990-A for 1962

(a) Enter the amount of contributions received during the period covered by your 1962 Form 990-A (line 17, page 1). $__________

(b) Enter the amount of such contributions which were in the form of cash. $__________

(c) Enter the amount of such contributions which were in the form of stock in any corporation with respect to which, at the end of the period covered by your 1962 Form 990-A, your organization held 10 percent or more of any class of stock. $__________

6. Market Value of Assets at End of Period Covered by Form 990-A for 1962

(Where no market quotations or detailed valuations are available to establish market value of assets, an approximation will be satisfactory.)

(a) Total Assets $__________

(b) Corporate Stock $__________

7. Certain Stock

(a) During the period covered by your 1962 Form 990-A, did your organization hold 10 percent or more of any class of stock in any corporation?

Yes (1) ☐
No (2) ☐

If the answer is "yes," answer question 8 on page 4.

8. If you answered "yes" to question 7. on page 3, answer questions (a) through (e) for each corporation in which your organization held 10 percent or more of any class of stock during this period. If your organization held more than one class of stock in such corporation, answer questions (a) through (e) with respect to each class of stock in which your corporation held 10 percent or more. Note that questions (d) and (e) refer to holdings at the end of the period. If your organization held 10 percent or more during the period but reduced this percentage (even below 10 percent) by sales during the period, answer questions (d) and (e) with reference to the end-of-period holdings. (Use additional sheets if necessary.)

(a) Name of corporation. (Abbreviate)	________	________	________
(b) Class of stock held (e.g. common, 6 percent preferred, etc.).	________	________	________
(c) Did your organization sell, or otherwise dispose of, any of this stock during the period covered by your 1962 Form 990-A? (Answer "yes" or "no.")	1. Yes ☐ 2. No ☐	1. Yes ☐ 2. No ☐	1. Yes ☐ 2. No ☐
(d) End of year holding -- For the shares of this class held by your organization at the end of the period covered by your 1962 Form 990-A give -			
(i) - Book value.	$________	$________	$________
(ii) - Market value.	$________	$________	$________
(iii) - Approximate percentage of total voting power.	________%	________%	________%
(iv) - Approximate percentage of total value of all classes of stock in the corporation.	________%	________%	________%
(v) - The total annual cash dividend on shares held at the end of the period.	$________	$________	$________
(e) Give the approximate percentage of the total value of stock in the corporation held at the end of the period covered by your 1962 Form 990-A by the creator and substantial contributors to your organization and their brothers, sisters, spouses, ancestors, lineal descendants; corporations owned (50 percent or more of voting stock or 50 percent or more of the value of all stock), directly or indirectly, by such creator or substantial contributors; and partnerships or other unincorporated business ventures in which the creator or substantial contributor owns 50 percent or more of the capital interests or profits interests. (If this information is unknown and not ascertainable, so indicate.)	________%	________%	________%

APPENDIX B

INTERNAL REVENUE SERVICE ADMINISTRATIVE ACTIVITY

The Internal Revenue Service has taken significant administrative measures directed at insuring that private foundations, and also other types of exempt organizations, operate in a manner consistent with the provisions of existing law. These additional efforts have taken five forms.

The first has been to increase the number of exempt organization returns which are audited each year. Whereas only approximately 2,000 of such returns per year were audited in the 1950's, over 10,000 exempt organization returns were examined in fiscal year 1964. As part of its increased examination program, the Service has improved the quality of each audit. Special classes to teach selected agents to deal with the special problems which are raised in an examination of a tax-exempt organization have been held. Special audit guidelines, which will permit agents to complete a thorough examination of a foundation's activities in a reasonable period of time, have also been prepared.

The Revenue Service's second major effort has been to increase the amount of available information concerning foundation behavior. This information will be useful to determine whether foundations are operating within the principles of existing law and, if not, the type of abuses which exist. The additional information will also be used to select certain returns for examination as well as for future statistical studies.

Consistent with the objective of obtaining more information, the Service has made substantial revisions in the information returns (Form 990–A) which private foundations are required to file. For example, the 1964 return requires private foundations to supply information with respect to the market value of their assets and detailed schedules of their accounts (and notes) receivable and payable. This information was not previously available from a foundation's return. The new form also substantially increases the amount of data which foundations must supply with respect to situations in which a foundation owns a significant—5 percent or more—portion of a corporation's stock. To the extent permitted by existing law, this new information will be made available to the public.

Third, improvements have been made in the Service's internal controls and procedures in the exempt organization area. For example, a check on delinquent and incomplete returns is now being performed in all district offices. This has contributed to the increase in the quality and quantity of exempt organization returns which are currently being filed. Similarly, an Exempt Organization Master File system—which will contain a list of the names and addresses of all exempt organizations—is presently being established. This list, which will be placed on magnetic tape, will permit the use of electronic data processing equipment to facilitate the administration of the tax laws dealing with exempt organizations.

The fourth major administrative effort being undertaken is to determine the scope of existing law through litigation. Appropriate cases are being diligently litigated by the Office of Chief Counsel of the Internal Revenue Service and by the Tax Division of the Department of Justice. A survey conducted during the spring of 1964 indicated there were approximately 250 cases involving exempt organizations in various stages of litigation. One of these is a case pending before the Supreme Court relating to the purchases of business corporations by private foundations. The decisions which will be rendered by the courts in these cases may help to provide valuable guidelines.

Fifth, the Service has increased its efforts to improve voluntary compliance with existing law. It was felt that many of the unintentional violations found upon audit are attributable to the organization not knowing what was expected of it. In order to educate the public the Service during 1964 published 25 Revenue Rulings, Revenue Procedures, and announcements relating to exempt organizations. Many others are currently under study. In addition, the Service has published a booklet entitled "How To Apply for Exemption for Your Organization," which is made available for distribution to interested parties. A more detailed booklet, similar to "Your Federal Income Tax," is now under active consideration. It is intended to provide more comprehensive guidance in complying with the law, and to do so in as simplified a style as is consistent with the complexities of the subject. It is hoped that these measures will sufficiently educate exempt organizations as to what is expected of them and will decrease the number of unintentional and technical violations of the law. This will permit the Service to devote its main efforts to cases involving intentional violations.

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